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THESIS

FREE TRADE AREA OF THE AMERICAS: A THREE LEVEL ANALYSIS

by

Clay G. Williams

March 2006

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The Free Trade Area of the Americas is a proposed treaty that would encompass the Western Hemisphere—800 million people and a 13 trillion dollar economy. It is a regional agreement that cannot be understood without the interrelated issues at both the international and domestic level. The single most important issue that resides at the nexus of all three of these levels is domestic subsidies on agriculture. FTAA cannot move forward at the regional level without reduction in the U.S. domestic subsidies. The United States is not willing to reduce its domestic protection without reciprocal reductions from the European Union, specifically, France. Even if international agreement is reached, the domestic level interest group politics must be factored in. Furthermore, the clock is ticking at the domestic level with both the President's Trade Promotion Authority set to expire along with the Farm Bill in 2007. The final analysis will indicate international negotiations will not yield enough genuine concessions soon enough to break the regional level loggerheads and that domestic interest group politics will not allow unreciprocated unilateral reductions to break that stalemate either. Free Trade in the Western Hemisphere is, therefore, likely to continue to progress as a series of subregional and bilateral agreements.

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FREE TRADE AREA OF THE AMERICAS: A THREE LEVEL ANALYSIS

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ABSTRACT

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I. WESTERN HEMISPHERE WIDE FREE TRADE AREA

> Although faced with differing development challenges, the Americas are united in pursuing prosperity through open markets, hemispheric integration, and sustainable development. We are determined to consolidate and advance closer bonds of cooperation and to transform our aspirations into concrete realities.

—Declaration of Principles from the First Summit of the Americas in Miami, Florida December, 1994

A. DO ECONOMICS MATTER?

After starting out with a tone of optimism in 1994 at the first Summit of the Americas, momentum for the Free Trade Area of the America's (FTAA) has dwindled and negotiations have reached an impasse. The principal opponents in treaty negotiations have been the United States and Brazil. Joining the United States in its position are its partners from previously negotiated trade agreements; the NAFTA nations of Canada and Mexico, Chile, and the recently ratified CAFTA nations—with some of the Central American nations yet to ratify that agreement in their own countries. Also, there are the nations with pending bilateral trade agreements like Colombia, Ecuador, and Panama as well as potential bilateral free trade candidates such as Uruguay. In the camp of Brazil are the Mercosur nations of Argentina, Paraguay, and until recently, Uruguay. Most of the remaining nations are content to let the major regional powers carry on the negotiations while the details of the potential agreement are being worked out. The scope of issues is broad, and it includes market access, investment, services, government procurement, dispute settlement, subsidies, antidumping, countervailing duties, agriculture, intellectual property rights (IPR), competition policy, smaller economies, civil society, electronic commerce, and institutional issues. At stake is a $13 trillion dollar a year economy affecting some 800 million people.

The issues have clustered such that the United States is seeking two main goals: market access for services and government procurement; and protection for investment and intellectual property rights. Brazil, on the other hand, is seeking market access to the United States' sensitive—and protected—sectors and, therefore, to dismantle the tools

that it claims the United States uses for protection of these sectors. This includes dispute settlement, antidumping, countervailing duties, subsidies, competition policy and agriculture. The issues important to the United States are, largely, more developed nation's concerns while the Brazilian issues are those of the less developed. Given that the entire hemisphere is less developed than the United States, the issue of genuine access to that world's largest market is the single most important issue. The United States must concede access to its sensitive sectors via reduction in domestic subsidies in order to get the rest of the hemisphere to agree to grant greater access to U.S. services and investment as well as guarantee protection of intellectual property—very important to many U.S. industries like pharmaceutical and entertainment. This issue of domestic subsidies has become the lynchpin for the FTAA agreement and success or failure of the hemisphere wide free trade area depends on what kind of access to protected sectors can be negotiated.

The sheer size and scope of the envisioned Free Trade Area of the Americas (FTAA) demonstrates its importance for not only the nations immediately involved in the negotiations but for most—if not all—of the industrialized trade-participating nations on the globe. The key issues being intensely negotiated will certainly have implications and repercussions for non-FTAA nations. The issue of domestic support is every bit as relevant and important for the European Union as it is for the United States—perhaps more so. Successful WTO negotiations over domestic support will have immediate ramifications for not only FTAA nations and the EU but also for Western Pacific nations, like Japan and China. If you consider how much of the world's trade is embodied in just those nations—United States, EU, Japan, and China—it amounts to most of the global economy.

It is these realities that give relevance and importance to matters of trade in measure equal to or greater than the sensational international law controversies of sovereignty, human rights, and the use of force. It is easy for developed industrialized countries to take economic fundamentals for granted. Economic well-being can become background noise when compared to the emotionally charged issues of the day. But it is a mistake to neglect the sheer power of economic well-being. Consider a hypothetical economic deal that would make the United States better off per capita by one penny a

day. A single penny a day has no intensity. Many, many people will not even stop to pick up a penny on the sidewalk. A penny a day, per person, however, is over a billion dollars in a year for the nation. To quote the late Senator Everett Dirksen from Illinois, "a billion dollars here and a billion dollars there, and before you know it you are talking about real money."[1] The point is that an economic deal that makes a country even a very little bit better off adds up to a very large economic gain when considered in aggregate—the challenge is to get this broad diffuse group of "winners" to recognize the importance of that single penny. Furthermore, while it may be easy for developed nations to somewhat forget about scrapping for economic gains, when you take into account developing nation's potential welfare improvement from even modest economic gains, the issue becomes more intense and relevant.

The proposed Free Trade Area of the Americas is one such economic deal that stands to garner significant gains in welfare for both the developing nations in the Western Hemisphere—there are thirty-two nations at various stages of economic development—as well as the developed nations of the United States and Canada. From its conception in 1994, the FTAA talks have stalled while the ultimate outcome remains in shadow. This paper will examine where the FTAA negotiations are, how they got there, and where they might go.

The single most important issue regarding FTAA negotiations is domestic subsidies. It is not the intent of this paper to establish some enduring relationship between trade liberalization and domestic subsidies, thereby establishing a theory that can be tested on other negotiations with other nations at other times. It is, rather, the intent of this paper to examine the constellation of issues surrounding the Free Trade Area of the Americas in these countries at this time. The goal will be to inform policy makers or others who are affected by intra-hemispheric relations that may be influenced by the FTAA process and its eventual outcome.

[1] The Senator frequently used this line to refer to Defense Department spending. Source: www.Google.com accessed March 2006.

B. THEORY AND FRAMEWORK

Robert Putman advocated for an interesting synthesis viewed through the lens of levels of analysis. His argument is that negotiators are constrained by the body that they represent.[2] A professional football player's representative negotiating with the owner's representative must strike a deal that is acceptable to the entire players' association. In the case with professional football players, the majority of the preferences are likely to be fairly homogeneous with some variation on what is considered acceptable salary caps, for example. When the example is taken to something with much broader and diverse first and second order effects, the constraints of the represented upon the negotiator can become much more significant. To wit, a trade negotiator must strike an agreement that can be ratified by Congress. This brings into play all the varied interest groups from specific trade sectors (i.e., wheat producers, textiles, citrus growers, etc.) to labor organizations to environmental groups, naming only a few. These very heterogeneous preferences with varying levels of influence significantly impact negotiations at the international level. In this simple example the two relevant levels of analysis are the international negotiator constrained by the domestic realities of Congressional ratification.

Mayer, in his book *Interpreting NAFTA*, goes a few steps further and describes the political analysis spectrum as containing three levels and three modes.[3] The three levels of analysis are international, domestic, and individual. The international level considers the state as a unitary actor and is useful where preferences are largely homogeneous and the decision making is considered to represent a unified preference or order of preferences. The domestic level disaggregates the unitary actor into multiple interest groups where preferences are more heterogeneous and the interaction between these groups determines the state's preference or order of preferences. The individual level further disaggregates the state all the way down to singular actors and takes into account their influences on the state's decision making. The further the disaggregation

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[2] Robert D. Putman, "Diplomacy and Domestic Politics: The Logic of Two-Level Games", *International Organization*, Vol. 42, No. 3 (Summer, 1988), 427-460.

[3] Frederick W. Mayer, *Interpreting NAFTA: the Science and Art of Political Analysis*, New York, Columbia University Press, 1998, 13.

the more involved and detailed the information necessary for the analysis to understand the actors' preferences and influences.

At the intersection of rational choice mode and domestic (or group) level lies political economy.[4] Jeffry Frieden explains this approach as one that simultaneously takes economics and politics seriously. It understands that decision makers will seek to maximize their interests but must be aware of economic impacts and market forces. At the same time, it understands the real impacts of interest groups, social effects, and the requirement to influence voters.[5] According to Jeffry Frieden, modern political economy analysis is a straight-forward process with four elements: actors and their goals, actors' policy preferences, groupings, and institutional interactions.[6] With these four elements we can take a building-block approach from small to big (from the actors' individual preferences to the combined interaction) to understand the political outcome.

Trade negotiations are, at their core, about maximizing economic gains. Each negotiating party is seeking their own interests and following their own hierarchy of preference. Through compromise, a mutually beneficial agreement can be reached where the two negotiating parties' order of preferences intersect or overlap—provided they do, in fact, overlap at some point. Therefore, these negotiators are easily located at the international level and the rational choice mode. They are, however, constrained in aligning their preferences with what is acceptable to their represented groups. Just like labor negotiators must make a deal that is acceptable to the represented unions, Free Trade Area of the Americas (FTAA) negotiators must make a deal that maximizes economic gains but that can be sold at home.

These actors at the domestic level take the economics seriously but they also take the politics seriously.[7] They make calculated assessments of "who benefits?", "how much?" and "what are the costs?". This rational assessment incorporating both economic factors and political realities is the essence of political economy analysis and is clearly

4 Mayer, 1998, 13.

5 Jeffry A. Frieden, "The Method of Analysis: Modern Political Economy", *Modern Political Economy and Latin America: Theory and Policy*, Boulder: Westview Press, 2000, xi.

6 Rivas-Campo and Benke, 2003, 37.

7 Frieden, 2000, xi.

the best analytical framework for understanding the FTAA. Taking Mayer's advice to be a "scientific naturalist", we will rely on political economy analysis as the most contextually and situationally appropriate to understand the constellation of issues that make up the proposed Free Trade Area of the Americas.

Having considered each protagonists goals, preferences, groupings and interactions, we can make an assessment of their best alternative to a negotiated agreement (or BATNA).[8] Once this relative negotiating threshold is determined it can be displayed graphically. Figure 1 shows an example of a generic BATNA diagram.

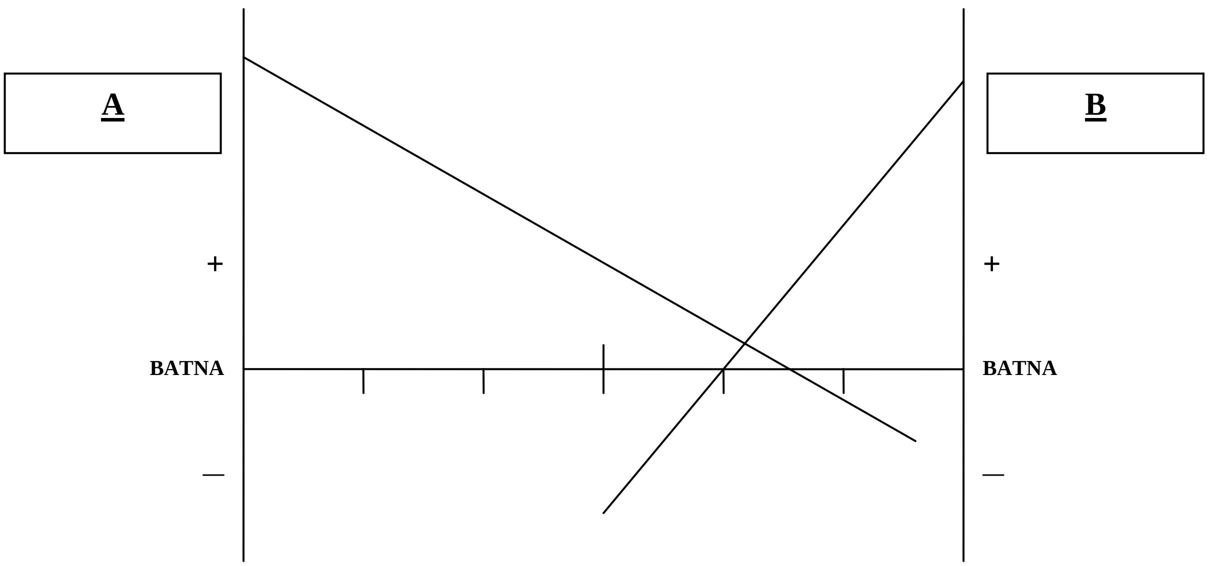

Figure 1. Generic BATNA Diagram[9]

No negotiating party should agree to any terms that are below their own determined BATNA. By definition, they are better off with no deal at that point. The

[8] Roger Fisher and Bill Ury coined the acronym BATNA, or "best alternative to negotiated agreement" to describe the course of action you would take if the proposed deal were not possible. Your BATNA may involve anything from walking away, to approaching another supplier, to bombing Serbia. The value of your BATNA to you sets the threshold of the full set of your interests that any acceptable agreement must exceed. This is also true for the other side. As such, BATNAs imply the existence or absence of a zone of possible agreement, and determine its location. Source: http://www.businesstimes.com.mt/251000/focus.html accessed March 2006.

[9] From: David R. Mares, *Violent Peace: Militarized Interstate Bargaining in Latin America*, New York: Columbia University Press, 2001, 9.

slope of their interest line on the BATNA diagram represents the strength of that negotiating position—the level of entrenchment. If the interest line is steeper then that outcome is more strongly desired; that is to say if that negotiating demand is not met then walking away is likely. If the interest line is flat then there is much greater tolerance for a variety of negotiated terms on a particular item. If the two protagonists' interest lines intersect above the BATNA line then an agreement is possible. If they intersect below that BATNA line, then no cooperative solution is possible.[10] In the generic example displayed in Figure 1, party B has a stronger negotiating position and is, therefore, more likely to walk away from the negotiations if its positions are not agreed to. Party A is more flexible and willing to accept a wider range of outcomes before walking away. In this example an agreement can be reached.

C. THREE LEVELS OF FTAA ANALYSIS

The best way to explore the FTAA and the critical issue of domestic subsidies will be at three levels, but we will modify Mayer's three levels to better fit the FTAA circumstances. The first level will be that multinational level where we will explore the impacts and issues surrounding domestic subsidies in the global arena. The second level will be the regional level where the FTAA exists. It will be a trade area encompassing thirty-four nations in the Western Hemisphere and, as such, it resides above the level of any individual nation yet below the nearly inclusive multinational level encompassed by the one hundred forty-nine nation strong World Trade Organization (WTO). The third, and final, level will be the domestic level where we will explore the considerations in the United States surrounding that lynchpin issue of subsidies. Figure 1 shows these levels of analysis.

[10] Mares, 2001, 9.

INTERNATIONAL LEVEL
149 WTO Nations
Major Protagonists: United States with G-20 and France with EU

REGIONAL LEVEL
34 Western Hemisphere Nations
Major Protagonists: United States and Brazil

DOMESTIC LEVEL
United States
Major Protagonists: Executive, Congress, lobbies, and consumers

Figure 2. Three Levels of FTAA Analysis

With our focus on the FTAA we will begin our analysis at the regional level and the FTAA process. The intent of the Chapter II analysis is to understand the broader constellation of issues surrounding FTAA and to point out that while there are numerous interrelated issues at play, the majority of them are fungible and negotiable. The single most important issue that is non-negotiable is domestic support. This is the *one* deal breaker and, as such, is the most important issue to grasp in order to understand the FTAA. In order to gain its preferences—IPR, services, investment protection and, government procurement—the United States must concede access to its protected sectors. Exploration of how to achieve this necessary reduction in domestic subsidies will lead us to the international and domestic levels accordingly. The United States' position in the FTAA negotiations to date is that it will not unilaterally reduce this protection. In order for the United States to reduce domestic subsidies it must gain reciprocal reductions from the world's other large and protected markets, specifically the EU and Japan. This position effectively tied the regional level FTAA negotiations to the international level WTO negotiations and leads the analysis naturally to the international level.

The intent of the Chapter III analysis is to understand the global considerations of domestic subsidies. At the multilateral level, the issues and concerns of the thirty-four FTAA nations are commingled with the issues and concerns of the remaining one hundred fifteen nations that make up the WTO. As such, the dynamic for considering domestic subsidies changes and this needs to be understood at the international level so

that its effects can be understood and predicted at the regional level on the proposed FTAA. What we learned from the regional level is that in order for the United States to "buy" the kind of FTAA deal that it wants, it must reduce domestic subsidies. Furthermore, the United States stated that such reductions had to be reciprocated by the EU and Japan. This chapter will, therefore, examine the progress in the WTO negotiations on mutual reduction in domestic subsidies. The international analysis will detail the significant challenges of obtaining multilateral reduction of protection for sensitive domestic sectors and conclude that at this time the French and the EU will not reduce protection enough to allow the United States to provide that genuine market access which would, in turn, facilitate the FTAA.

If multilateral reductions cannot occur, then what is the likelihood of unilateral reductions by the United States? This question leads the analysis from the international level to the domestic level. To understand subsidies at the regional and international level is to understand the cost / benefit comparisons considered nation to nation. To understand subsidies at the domestic level is to delve into interest group politics where small organizations of highly incentivized sectors have brought to bear significant resources and political leverage through lobbying efforts to maintain the financial security of the status quo. These issues become iconic and highly politically charged topics where the potential "losers" are a small group of farmers, manufacturers, ranchers, or growers. The "winners" are the American people at large who will gain the benefits of competitive free trade—greater selection at lower prices. This group of "winners", however, is a vast group that benefits individually very little. Taken in aggregate this small benefit over the greater population is a much more significant gain than that which would be lost by the "losers". The magnitude of this gain, however, is, largely, insufficient to motivate the individual "winners" to advocate for themselves. The "losers" on the other hand are intensely motivated to advocate for themselves because the magnitude of loss for them as individuals is quite significant. Therefore, we find ourselves in the circumstances where the greater good is difficult to arrive at because one side of the issue is exerting a tremendous amount of influence and is represented by real individuals with sad stories to tell while the other side of the issue is represented by the abstract reality of the benefits of free trade and increased competition. This side of the

argument suffers from the very real fact that true free trade with open competition is very intolerant of ineffective or inefficient practices. This reality casts free trade in a harsh, cold light that doesn't always resonate as strongly as the sad stories that the losers are able to portray. These iconic images are utilized in the war of images to garner political and public support. Chapter IV will look at the intense difficulties that would face policy-makers here in the United States were they to try to reduce domestic support. The conclusion from this analysis will show that such reduction can only occur in the face of reciprocal reductions from the EU and Japan. In the absence of this reciprocity, there can be no unilateral reduction of U.S. domestic subsidies. Without reduction in subsidies—multilateral or unilateral—there can be no FTAA as currently envisioned by the United States.

II. REGIONAL ANALYSIS

> We have a great vision before us: a fully democratic hemisphere, bound together by goodwill and free trade. That is a tall order. It is also the chance of a lifetime. And it is the responsibility we share.
>
> —George W. Bush, Summit of the Americas, April 2001

A. INTRODUCTION – REGIONAL LEVEL

The proposed Free Trade Area of the Americas is an agreement that exists at the regional level; as such, this is the logical place to begin the analysis. Identifying the constellation of regional issues and specifying which of these have the most gravitational pull, will allow us to identify those issues at the other levels that will have the largest effect on the FTAA and will, therefore, assist our "naturalist" selection and allow the scope of analysis to be focused on those critical issues without digressing unnecessarily into lengthy sidebars. This chapter will, however, include enough detail to provide sufficient background at the regional level to fully inform policy decision-makers as well as those in a position to be directly affected by the ultimate outcome of these negotiations. The goal is to make clear to those affected the complex and interrelated factors that surround the FTAA.

In December of 1994, the heads of state of the thirty-four[11] democratic nations within the Western Hemisphere convened at the Summit of the Americas in Miami, Florida. At this meeting they agreed to embark upon an ambitious regional trade liberalization journey with a desired end of the formation of a hemispheric wide free-trade bloc called the Free Trade Area of the Americas (FTAA). If successfully formed, the FTAA would encompass over 800 million people and a 13 trillion dollar economy stretching from Ushuaia on the southern tip of Tierra del Fuego in Argentina over eight thousand nautical miles north to Alert on the northern tip of Ellesmere Island in Canada.

[11] The 34 nations negotiating FTAA, in alphabetical order, are: Antigua and Barbuda, Argentina, the Bahamas, Barbados, Belize, Bolivia, Brazil, Canada, Colombia, Chile, Costa Rica, Dominica, the Dominican Republic, Ecuador, El Salvador, Grenada, Guatemala, Guyana, Haiti, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay, Peru, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Suriname, Trinidad and Tobago, the United States, Uruguay, and Venezuela. Cuba is excluded.

It would be, by far, the largest in physical size and population with over twice the 375 million people included in the European Union.[12]

Between its inception in 1994 and the formal initiation of trade negotiations in April of 1998, four ministerial meetings and a Second Summit meeting were held and agreements were reached on the overall scope and structure. It was decided that the FTAA would be a single undertaking where, similar to World Trade Organization (WTO) agreements, members must agree to all parts of the negotiated trade deal vice being able to opt out of any particular parts that they do not like. Also, all agreements would be reached by consensus. It was agreed that FTAA would go beyond WTO stipulations where possible and that bilateral and subregional blocs within the FTAA members could negotiate as blocs if desired. Lastly, it was agreed to strive for transparency during the negotiations with the draft agreements being made available in the four languages (English, Spanish, French, and Portuguese) on the Internet and accepting inputs from civil society.[13] The process was organized with a sub-ministerial Trade Negotiations Committee (TNC) overseeing nine negotiating groups and four advisory committees. The nine negotiating groups are: Market Access; Investment; Services; Government Procurement; Dispute Settlement; Subsidies, Antidumping, Countervailing Duties (a.k.a. Trade Remedies); Agriculture; Intellectual Property Rights (IPR); and Competition Policy. The four additional committees are: Consultative Group on Smaller Economies, Committee on Civil Society, Committee of Experts on Electronic Commerce, and, Technical Committee on Institutional Issues. Both the size of the envisioned trading area and the scope of the anticipated agreement made this undertaking a significant instrument of international law and trade liberalization. President Bush was correct when he called this undertaking both “a tall order” and “the chance of a lifetime.”

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[12] Raymond J. Ahearn , *Trade and the Americas*, CRS Issue Brief for Congress IB95017, September 2003.

[13] See various GAO reports including: *FREE TRADE AREA OF THE AMERICAS: Negotiators Move Toward Agreement That Will Have Benefits, Costs to U.S. Economy*, GAO-01-1027, September 2001; *FREE TRADE AREA OF THE AMERICAS: Negotiations Progress, but Successful Ministerial Hinges on Intensified U.S. Preparations*, GAO-03-560, April 2003 and; *FREE TRADE ARE OF THE AMERICAS: Missed Deadline Prompts Efforts to Restart Stalled Hemispheric Trade Negotiations*, GAO-05-166, March 2005. See also Jose Antonio Rivas-Campo and Rafael Tiago Juk Benke, “FTAA Negotiations: Short Overview”, <u>*Journal of International Economic Law*</u>, September 2003, Vol. 6, No. 3, ABI/INFORM Global, 661-694.

Between the Second Summit and April 2001, two more ministerial meetings and a third summit meeting took place and the negotiating groups completed the first draft agreement consisting of inputs from any negotiating party that wanted to submit text for the agreement. Any disputed text within this draft agreement was set aside in brackets for later resolution. This first draft agreement was heavily “bracketed” since no actual negotiations occurred on any of the submitted text.

Between the Third Summit in 2001 and the Seventh Ministerial in November 2003, the negotiating groups removed much of the redundant language and worked towards consensus within the negotiating groups on the language for their chapters resulting in a second draft agreement being released at this Quito Ministerial meeting. Additionally, a firm timeline was agreed upon with a final treaty to be signed by January 2005 and entry into force of the agreement by December 2005. There was a significant reduction in the amount of “bracketed” text on the second draft but that was largely due to the removal of duplicative language, not to broad consensus being reached. In arriving at this second draft version of the agreement, most of the modalities were hammered out and the only work left to do was the real horse-trading to reach common ground on the language. By this time it was clear that Brazil and the United States had vastly different positions on several critical negotiating areas and that much of the rest of Latin America was content to let Brazil advocate firmly for their commonly held positions.

When the formal negotiations began in 1998, the process was broken into eighteen month windows with a new chair each period. The chair, in addition to being responsible for their own nation’s negotiating interests, was also responsible for shepherding the process along by scheduling meetings and issuing directives for milestones and deliverables for those meetings. Coincident with the Quito Ministerial, the United States and Brazil assumed co-chair responsibilities and were to keep these positions until the conclusion of negotiations in January 2005. Some were convinced that this was the way to expedite the negotiating process because if the co-chairs had already reached consensus on controversial issues then the rest of the parties could probably also agree to the language. Others felt that this arrangement would delay the overall process because now the co-chairs themselves had to conduct negotiations on every single aspect of the negotiating process before any of these processes could move forward. As it

turned out, the latter was true. Unable to reach common ground on key issues, the co-chairs simply failed to keep the process moving along. Negotiations ground to a halt in 2004 and the January 2005 deadline came and went with no agreement.[14]

B. KEY PROBLEMS – REGIONAL LEVEL

These "battleground" issues that the negotiating groups were (and still are) unable to reach common language on are: agricultural subsidies (domestic support), trade remedies (specifically antidumping), intellectual property rights (IPR), and environmental and labor concerns (with regards to both production and investment attraction).[15] With a political economy analysis this paper will explore the United States' and Brazil's negotiating positions on these "battleground" issues. We will see later in this chapter as well as in subsequent chapters that subsidies and trade remedies are heavily influenced by the international level. That is to say, decisions on these issues at the regional level would have significant implications at the international level and vice versa. That being said, there are significant implications regarding domestic subsidies right here at home. Likewise, IPR, environmental protection, and labor standards are issues that resonate most clearly at the U.S. domestic level. Furthermore, as these issues are interrelated, we will see that there is room for some give and take on most of these issues but that the single most important concern is domestic subsidies and the resulting trade distortions. We will see that the investment in this issue at all three levels places this single topic at the center of the FTAA constellation of issues.

Most of the key problems at this level are the negotiating points themselves. The key issues in the negotiating process have been introduced above and will be discussed below as they impact the FTAA. Beyond the particular positions in negotiations, one complicating factor is Brazil's aspiration to be a regional leader. This aspiration may lead Brazil to think it has to show the region how strong and independent it is and make reaching mutually beneficial negotiations harder. If this factor turns out to be significant, expect Brazilian negotiating positions to be more strongly entrenched and for the traditional negotiating starting positions—where the "buyer" starts out very low and the

14 GAO Report, *Missed Deadline*, 2005, 25.

15 Rivas-Campo and Benke, 2003, 667.

"seller" starts out very high—to be more extreme. In real terms this means that Brazil may more firmly demand greater reductions in protectionist measures and may more firmly resist concessions on protections—for both investments and IPR—and reductions on barriers to services and government procurement access.

C. POLITICAL ECONOMY ANALYSIS – REGIONAL LEVEL

Having laid out all the requisite background information, the political economy analysis will be a straight-forward assessment identifying the players and their goals, the players' policy preferences, the groupings that occur, and the institutional interactions.

1. Actors and their Goals

While there are 34 actors involved in the FTAA process, the battle lines have been clearly drawn between the United States and Brazil with the remaining 32 nations either tacitly in the camp of one or the other or with policy preferences somewhere in between that could favor either camp.[16] Bear in mind that the United States is, by far, the largest importer and exporter in the hemisphere and that Brazil encompasses fully 40% of South America's economy, which greatly strengthens both nation's proxy position within the hemisphere. By and large the goals of Brazil and the United States are similar. They both want to ensure sustained economic growth and free-market commerce. Commerce Under Secretary for International Trade Grant Aldonas summarized the U.S. goals with this:

> Trade has the capacity to lift nations and people. Freer trade leads to expanded choices. Consumers benefit from lower prices and access to a greater variety of products, better and more affordable health care, and increased opportunities. Workers benefit from new and often higher-paying jobs. And farmers gain access to new markets…Nations will form closer ties as their economies become more integrated and interdependent, potentially resulting in eased political tensions and uniform democratic values across borders.[17]

Brazil's Ambassador to the United States enumerated similar goals with this:

[16] GAO Report, *Missed Deadline*, 2005, 13.

[17] Grant D. Aldonas, "The FTAA: Mapping the Road to Economic Growth and Development", *Economic Perspectives*, Vol. 7, No. 3, October 2002, 17.

> The ultimate goal of the process is not free trade for its own sake, but rather achieving the developmental, technological, economic, social, and political gains that we believe an FTAA can help generate.[18]

Commitment to the goal of successful conclusion of an FTAA was made in 1994 at the Summit of the Americas by all 34 participating nations. The differences arise in the details of just what that FTAA looks like, which brings us to analysis of policy preferences.

2. Policy Preferences

The Ministerial level spokesman for the United States was U.S. Trade Representative Robert Zoellick. In order to achieve the United States' hemispheric goals, USTR Zoellick and his negotiating team proposed language and advocated for several sweeping policy recommendations.

In the field of Intellectual Property Rights the United States enjoys a clear superiority in the hemisphere and across the globe in such technologically involved industries as pharmaceuticals, telecommunications, software development, and entertainment—made more complicated in a digital world. This advantage in these and other "knowledge-based industries"[19] represents an enormous commitment and investment as well as an enormous potential in earnings. To protect these existing "products" as well as emerging ones such as biotechnology and e-commerce, the United States prefers strong, "state-of-the-art" IPR enforcement.[20] Baseline IPR standards already exist within the WTO Agreement on Trade-Related Aspects of Intellectual Property (TRIPS) but many of the FTAA nations are lax or unable to enforce even these measures. The United States' proposal goes beyond the TRIPS measures as it did with the NAFTA agreement. Given that TRIPS enforcement is not robust, the United States is adamant to not allow a weaker IPR chapter in an FTAA agreement to undermine those standards despite the recognized challenges to small economies of allocating scarce resources.

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[18] Rubens Barbosa, "Brazil and the United States Overcoming Obstacles to an FTAA", *Economic Perspectives*, Vol. 7, No. 3, October 2002, 23.

[19] GAO Report, *Negotiators Move*, 2001, 58.

[20] GAO Report, *Negotiators Move*, 2001, 60.

The United States prefers a policy of retaining existing trade remedy tools including antidumping and countervailing tariffs. One of the principal negotiation objectives that was written into the Trade Promotion Authority (TPA—formerly "fast-track")[21] legislation was:

> To preserve the ability of the United States to enforce rigorously its trade laws, including the antidumping (…) and safeguard laws, and avoid agreements that lessen the effectiveness of domestic and international disciplines on unfair trade, especially dumping and subsidies,…[22]

Clearly, the U.S. position is in favor of retaining existing remedies and, even if a deal was offered to trade those remedies for some other concessions, the negotiators hands are tied by the TPA. It similarly limits the authority of the negotiators on this admittedly controversial issue to entertain fully alternatives such as safeguards.

The TPA also directs that standards for labor and the environment be adhered to in the pursuit of trade liberalization.[23] The U.S. position here is based on the concern that lax standards for the protection of worker's rights and environmental damage will afford those countries lower costs in the production of exports and may unfairly attract investment for those lower-cost industries. In addition to concern for universal rights and environmental externalities, the United States sees these standards as vital for fair free trade.

Similar to the advantage in intellectual property, the United States is the world's leader in exported services[24]—transportation, financial, tourism and telecommunication, for example—and is one of the world's leaders in both government procurement and investment. As such, gaining market access for services and government procurement will reap significant economic benefits for these important U.S. sectors and codifying protection for its investors will ensure current and future benefits from this practice. The United States, however, doesn't have sufficient bilateral or multilateral agreements that

21 "TPA sets a number of U.S. trade negotiating objectives relevant to the FTAA, and outlines procedural requirements for the executive branch to fulfill as conditions for expedited congressional consideration of legislation to implement trade agreements." Source: GAO Report, *Missed Deadline*, 2005, 7.

22 Rivas-Campo and Benke, 2003, 672.

23 Rivas-Campo and Benke, 2003, 678-679.

24 GAO Report, *Negotiators Move*, 2001, 41.

protect or provide guaranteed access for these sectors. For example, the United States and Canada are the only FTAA nations that have signed on to the WTO agreement covering fair competition for government contracts.[25] Many of the FTAA nations instead provide preferential treatment to domestic firms for awarding government contracts. Liberalization in this sector as well as services and investment protection will yield large benefits to the United States.

The United States prefers liberal market access with little or no tariffs. The reservation to this preference is for limited sensitive sectors—sugar, citrus, steel, and beef, for example—and for domestic support—such as the Farm Bill. While the number of protected sectors is limited, the effect of these trade distorting policies is anything but limited. We will see at the international level that protection of domestic agricultural sectors has its strongest roots in the post-WWII days when an adequate supply of food was anything but assured. While that necessity has been alleviated over the decades the intensity over this issue has not abated a great deal. That being said, negotiations in the market access group have made sufficient progress because subsidies are specifically in a separate negotiation group.

The United States does, however, prefer a policy of differentiated market access to shelter the smaller economies in the hemisphere. The United States already has several agreements in place providing preferential tariff rates to many of the smaller economies in the Caribbean, Central American, and Andean regions and would like to maintain this treatment so as to provide shelter from the large hemispheric economies of scale.[26]

The United States does, in fact, advocate liberalizing non-tariff barriers to trade such as eliminating export subsidies[27] and reducing domestic support.[28] It does not, however, advocate reducing these barriers in a regional agreement without multilateral

[25] GAO Report, *Missed Deadline*, 2005, 19.

[26] Rivas-Campo and Benke, 2003, 677-678. See also, GAO Report, *Missed Deadline,* 2005, 10.

[27] "Export subsidies are subsidies contingent on export performance. They include cost reduction measures, such as subsidies to lower the cost of marketing goods for export, and internal subsidies applying to exports only". Source: GAO Report, *Missed Deadline*, 2005, 7.

[28] "Domestic supports are payments made to farmers that raise prices or guarantee income. They include such measures as government buying at guaranteed prices, commodity loan programs, and direct payments to farmers." Source: GAO Report, *Missed Deadline*, 2005, 7.

buy-in from significant non-FTAA economies that practice heavy subsidization—Japan and the EU. The strongly held U.S. opinion is that reducing these non-tariff barriers would correctly liberalize the regional trade but would unfairly advantage non-FTAA subsidizers and would simultaneously remove the bargaining leverage to achieve this liberalization in a multilateral format. Therefore, the U.S. policy preference is to resolve these trade issues in the WTO forum—where the United States has made offers of 50% reductions in agricultural subsidies—so as to gain buy-in from all the global competitors.[29] Furthermore, the United States does not believe that non-tariff elimination is necessary for FTAA members to reap significant trade increases. NAFTA serves as an example where tariffs were reduced or eliminated but agricultural subsidies remained untouched yet Mexico's agricultural exports to the United States increased 60% between 1993 and 1999.[30]

Brazil's negotiating duties are headed up by the Minister of Foreign Relations Celso Luiz Nunes Amorim. Some of Brazil's policy preferences are close to the U.S.' preferences and some are dramatically divergent.

Brazil wants market access to span the entire universe of tariffs, with no exceptions for sensitive sectors. Furthermore, Brazil wants to see the complete removal of any barriers to trade or trade-distorting practices. This includes the elimination of export subsidies and domestic support.[31] Brazil feels that domestic support is an unfair trade practice that only developed countries can practice because developing economies simply do not have the resources to support it. Therefore, to reduce or remove tariffs but allow subsidies to remain would give unfair advantage to the United States and specifically disadvantage the developing nations in Latin America.[32] It would be difficult to overstate the significance of access to the U.S. market for Brazil and all of the other FTAA nations. This access is the payoff that this trade liberalization brings. By and large, the other issues are the costs that these nations must pay in order to buy this market access.

[29] GAO Report, *Missed Deadline*, 2005, 20-21.

[30] Rivas-Campo and Benke, 2003, 670-671.

[31] GAO Report, *Missed Deadline*, 2005, 20.

[32] Rivas-Campo and Benke, 2003, 670.

Additionally, Brazil prefers to establish regional Most Favored Nation (MFN) status vice using a differentiated market access approach. Brazil currently enjoys no preferential access to the U.S. market; in fact, it feels it faces quite the opposite. Many of the U.S. targeted tariffs are for protection in sectors that Brazil is also a significant producer—sugar, soy, and beef, for example. With the United States' differentiated proposition, Brazil faces the slowest access to the U.S. market of any of the FTAA nations. Incorporation of a regional MFN status would automatically convey any tariff reduction to all member nations. Brazil's—and every other nation's—access under these circumstances would be equally applied, regardless of economy size.[33]

Brazil has a diametrically opposed position to the United States regarding trade remedies. The draft language for Article 16.1 directed that "countries shall renounce the use of antidumping measures for reciprocal trade."[34] Brazil considers antidumping remedies to be protectionist policies that shelter domestic sectors from foreign competition and would prefer to see its practice ceased and replaced with alternative measures like safeguards or different competition disciplines.[35]

Similarly, Brazil considers excessive labor and environmental standards as protectionist measures and does not feel that they are appropriate for inclusion in trade liberalization. The Quito Ministerial in 2002 reflected the tension on this issue with the following:

> Most ministers recognized that environmental and labor issues should not be utilized as conditionalities nor subject to disciplines, the non-compliance of which can be subject to trade restrictions or sanctions.[36]

Brazil recognizes that its economy is unable to compete against the United States in areas such as services, investment, intellectual property, and government procurement.[37] Therefore, its preference is to concede as little liberalization in these

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[33] Rivas-Campo and Benke, 2003, 677. See also, GAO Report, *Missed Deadline,* 2005, 10.

[34] Rivas-Campo and Benke, 2003, 672.

[35] Rivas-Campo and Benke, 2003, 672-673.

[36] Rivas-Campo and Benke, 2003, 679.

[37] J.F. Hornbeck, *A Free Trade Area of the Americas: Major Policy Issues and Status of Negotiations,* CRS Report for Congress RS20864, January 2005, 3.

sectors as is possible which means maintaining the status quo where WTO already covers the topic.

For IPR specifically, Brazil—and many other Latin American nations—lack the resources to meet even the WTO TRIPS requirements, let alone, enhanced "state-of-the-art" enforcement. Brazil, therefore, prefers to maintain the WTO status quo, at most, and desires technical and resource assistance to accomplish that.[38] Furthermore, Brazil questions whether IPR is beneficial for developing nations. There is some debate on whether or not strict IPR enforcement enhances the spread of technology and increases Foreign Direct Investment (FDI) and, therefore, Brazil may prefer to undermine the WTO standards for IPR.[39]

3. Groupings

In an effort to bolster support for their particular policy preferences, both the United States and Brazil have actively engaged in sub-regional and bilateral agreements. Successful implementation of these individual agreements sets precedence for trade liberalization policies and gathers momentum for whichever camp is able to sign on the most supporters. Brazil's significant grouping within the region is Mercosur (the common market of the south) and Brazil has successfully led that bloc's negotiating position.[40] Brazil has also engaged multiple nations outside of the region including Africa, India, and the Association of South East Asian Nations (ASEAN). Additionally, Mercosur has engaged the EU on trade liberalization but has become hung up on many of the same issues that frustrated FTAA negotiations.[41]

The United States' most significant sub-regional agreement is, of course, NAFTA which embodies virtually all of the liberalizing policies that the United States wants to incorporate into an FTAA. In addition to NAFTA, the United States has negotiated a bilateral agreement with Chile as well as the Central American Free Trade Area

[38] GAO Report, *Missed Deadline*, 2005, 21.

[39] Hornbeck, 2005, 5.

[40] Mercosur consists of Brazil, Argentina, Uruguay, and Paraguay and has strategic alliances with Chile and Bolivia.

[41] GAO Report, *Missed Deadline*, 2005, 22.

(CAFTA)—which also includes the Dominican Republic. The United States has negotiated FTA agreements with twelve nations and is currently negotiating with twelve more both within the hemisphere and outside of it. The more broadly the United States can spread its version of liberal trade, the more commonly accepted its version will be. Additionally, the United States is counting on good economic performance from its negotiated partners to set an example for the benefits of free trade with U.S.-preferred policies. Critics argue that negotiating resources and energies are being diverted from FTAA to these subregional and bilateral agreements and that FTAA has and will continue to suffer. It also risks becoming irrelevant if the United States can achieve its desired access without an FTAA.[42] Still other critics argue that energy spent in negotiating the FTAA is a diversion and distraction to the more important multilateral discussions at the WTO level.

4. Institutional Interactions

These opposing sets of policy preferences and their associated groupings are interacting in two significant institutions. One represents an existing institution at the international level—the WTO—and the other represents the institution that is under formation—the FTAA itself at the regional level. The United States' primary institutional interactions have been with the WTO. With the United States' insistence that agricultural subsidies, arguably the most significant FTAA issue, as well as trade remedies, arguably the second most important FTAA issue, be negotiated in a multilateral forum, FTAA negotiations were put on a parallel track with WTO negotiations. When those WTO negotiations stalled, that rippled right into the FTAA negotiations and brought them to a halt.[43]

While Brazil has also interacted with the WTO regarding FTAA issues—preferring to negotiate IPR multilaterally as well as trying to resolve the critical agricultural subsidy issue—it has also significantly interacted with the FTAA institution itself. Whereas the United States worked to negotiate within the established framework and modalities for the FTAA, Brazil dramatically shifted the institutional vision for

[42] GAO Report, *Missed Deadline*, 2005, 22.

[43] GAO Report, *Missed Deadline*, 2005, 12.

FTAA. When it became obvious to Brazil that FTAA as envisioned was hung up, they put on the table their "Three Track Proposal" calling for "(1) bilateral FTAA negotiations to focus primarily on market access for goods and services; (2) regional FTAA negotiations on rules for several issues not covered by the WTO, including competition policy and dispute settlement, and (3) leaving six of the original nine issues out of the FTAA altogether and moving them to the WTO Doha Round negotiations."[44] The United States did not agree to this proposal mainly because many of the issues that Brazil wanted to shift to WTO were not on the agenda for discussion during the Doha Round so the United States would have found itself in a position where some of its critical interests—investment, IPR, and government procurement—would not be addressed in either FTAA discussions or WTO discussion. It did, however, accept the "Two-tier" approach where a common level of rules and rights is established for all 34 nations and from there, nations can bilaterally agree on further obligations. From the initial starting point of an all-encompassing singular undertaking with consensus decisions and equal treatment for all, Brazil altered the proposed institution to one where "countries may assume different levels of commitments …[with a] common set of rights and obligations applicable to all countries…[and may also] chose, within the FTAA, to agree to additional obligations and benefits."[45]

D. IMPLICATIONS – REGIONAL LEVEL

The 2003 Ministerial Declaration, jointly released by Brazil and the United States, effectively signaled the end of FTAA negotiations. There was a TNC meeting in February of 2004 that was supposed to identify the common lower-tier elements for the proposed "FTAA-lite" or "Two-tier" approach, but no agreement was reached and no further meetings were scheduled. With the double-whammy of failed WTO negotiations denying resolution on the critical agricultural and trade remedy issues and the new institutional framework effectively erasing the original embodiment of hemispheric free-trade with equal treatment, FTAA became still-born.

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44 GAO Report, *Missed Deadline*, 2005, 10-11.

45 Hornbeck, 2005, 5.

The basic facts of the matter are that most of the U.S. imports come into the country with little or no tariff with some significant exceptions. The areas that are protected the most in the United States are the areas where Brazil and other hemispheric nations are highly competitive. Furthermore, most of the U.S. exports into the non-NAFTA hemisphere face relatively high tariffs but the significance of this is lost in the scale of the U.S. economy. It is predicted that U.S. agricultural exporters stand to gain an annual increase of $1.5 billion in exports but this represents only about one percent of the total U.S. economy.[46] It is equally true that most of the rest of the hemisphere stands to gain very little from increased competition in services, investment, intellectual property, or government procurement. What the United States wants to gain from an FTAA is increased market access for those areas and what it has to offer in order to gain them is increased U.S. market access for goods and more "friendly" trade remedies. What Brazil insists on gaining is real increased access to the U.S. market for many of its highly competitive goods and what it must give up to get that is increased access for the United States in services and government procurement and increased protection for U.S. investments and intellectual property.

What remains is for Brazil to make its offer sufficiently robust that the U.S. gains are genuine and for the United States to make its offer sufficiently robust that Brazilian access to the U.S. market is genuine. When the United States insisted on tying its only real negotiating levers to the WTO, it bound the fate of the FTAA to success or failure of WTO negotiations. Since the failure of the last WTO round—and the subsequent failure of FTAA—some encouraging progress was made and it was optimistically anticipated that the modalities for negotiating agricultural subsidies could be in place by the December 2005 WTO round. Additionally, USTR Zoellick met with Foreign Minister Amorim in February 2005 resulting in cautious optimism that FTAA could progress with the WTO progression. What is unclear is what version of FTAA may come from successful WTO negotiation. What is clear is that passage of CAFTA by the U.S. Congress indicates which way the wind is blowing in the United States regarding trade liberalization within the hemisphere. The indication from CAFTA is that the support is still there—albeit by a narrow margin. Hopefully the Congress will demonstrate

46 GAO Report, *Negotiators Move*, 2001, 89.

commitment to hemispheric liberalization and can carry that momentum into TPA consultations that allow sufficient negotiating latitude to achieve global liberalization in the WTO process and subsequent hemispheric liberalization with a genuine, single undertaking.

Figure 3 graphically depicts the FTAA negotiations at the regional level. The U.S. line is steeper than the Brazilian line because the U.S. position is stronger. That is to say, if no trade agreement is reached, Brazil stands to be worse off than the United States. Despite this assessment of actual Brazilian interests the current Brazilian position is that without reductions, no deal is possible.[47]

The solid U.S. interest line depicts their position in the absence of reciprocal reductions at the international level. The dashed U.S. line depicts their interests if they are able to achieve WTO reductions of domestic subsidies. Agreement is, therefore, only possible if the United States is able to reduce its subsidies.

[47] Issues are on the table for explicit agreement. Positions are your stands on the issues. Interests are underlying concerns that would be affected by resolution. Source: http://www.businesstimes.com.mt/251000/focus.html accessed March 2006.

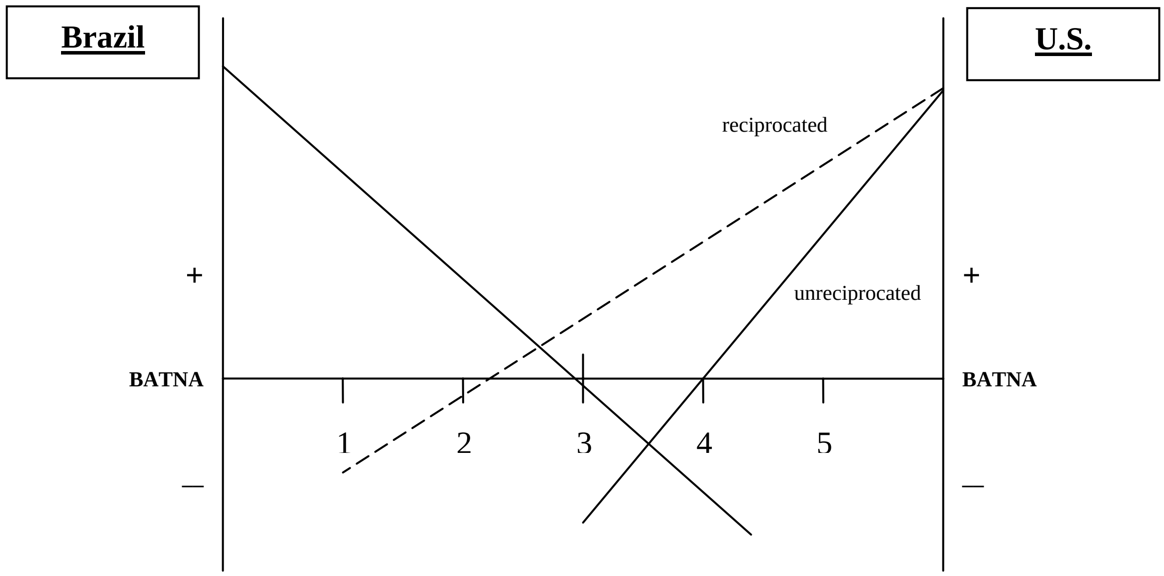

Figure 3. Domestic BATNA Diagram

1. Subsidy reduction, no services / procurement access, no investment or intellectual property protection, no environmental or labor standards.
2. Subsidy reduction, small access / protection, no environment / labor.
3. No subsidy reduction, small access / protection, no environment / labor.
4. No subsidy reduction, small access / protection, small environment / labor.
5. No subsidy reduction, full access / protection, stringent environment / labor.

It can be seen that this issue of domestic subsidies is of singular importance at the regional level and is also heavily tied into both the international and domestic levels. The basic implication of the regional analysis is that the quality of the FTAA depends on the actual amount that domestic subsidies can be reduced. The United States has clearly stated that it needs to achieve these reductions in a multilateral manner with reciprocity from the other large industrialized markets. As such, we will move on with our analysis to the international level with a close look at this topic, specifically, as it impacts the FTAA.

III. INTERNATIONAL ANALYSIS

Will this [meeting] yield any substance, or should everyone go shopping?

—Pascal Lamy, Director General of the WTO, Hong Kong ministerial, December 2005.

A. INTRODUCTION – INTERNATIONAL LEVEL

To date, the firm negotiating positions of Brazil and the United States have indicated that reductions in domestic subsidies are both necessary for the FTAA to be realized and that these reductions need to be reciprocated by the other WTO nations. Our focus will, therefore, shift to this level and we will explore the constellation of issues that impact this larger body of nations on this sensitive topic. The direct question for the FTAA process is whether or not these reductions in domestic subsidies can be achieved at the international level.

The World Trade Organization (WTO) came into being in January 1995 as one of the successful outcomes of the Uruguay Round (UR) of negotiations of the General Agreement on Tariffs and Trade or GATT. While the WTO is only ten years old, it represents the evolution of almost sixty years worth of global trade negotiation and agreements. The concept of an international organization responsible for global trade first emerged in the post-WWII Bretton Woods conference where the International Trade Organization (ITO) was conceived. The ITO failed to survive U.S. Congressional ratification and the General Agreement on Tariffs and Trade (GATT) was created—an agreement vice a formal institution. At its inception the GATT was a treaty covering tariffs between only 12 nations.[48] Today the WTO consists of 149 participating nations—with Saudi Arabia's entrance on 11 December 2005—that encompasses approximately 97 percent of world trade and spans many additional issues influencing trade beyond tariffs.[49]

48 Anne McGuirk, "The Doha Development Agenda," *Finance and Development*, Vol. 39, No. 3, September 2002 at http://www.imf.org/external/pubs/ft/fandd/2002/09/mcguirk.htm accessed December 2005.

49 Meredith A. Crowley, "An Introduction to the WTO and GATT," Economic Perspectives, 4th Quarter 2003. 43.

The workings of the GATT entail periodic negotiating rounds spanning several years. In the 1980s, however, some of the shortfalls of the GATT came to the forefront on the international arena. First, nations were unable to successfully resolve disputes between signatory nations. Second, many commodities were exempt from GATT disciplines as member nations specifically excluded them so as to maintain protectionist measures for those politically sensitive sectors of their domestic economies, specifically agriculture and textiles. Third, nations accused other nations us utilizing anti-dumping and countervailing duties as protectionist policies instead of legitimate responses to material injury. Finally, important issue areas such as trade in services, investment, and intellectual property rights (IPR) were not covered at all in the GATT disciplines.[50] To address these problems the Uruguay Round began in 1986 in Punta del Este and saw a dramatic expansion in the scope of topics to be negotiated. The fifteen original Uruguay Round subjects included: tariffs, non-tariff barriers, agriculture, subsidies, intellectual property, services and dispute settlement, to name only half of the issues.

The existing GATT already covered agriculture, but it contained loopholes that allowed nations to protect specific sectors with import quotas and subsidies – both direct support and export subsidies. These measures provided the desired economic support to those sectors but at the expense of distorted trade. Such subsidies would not have been permitted under GATT disciplines for industrial products and many nations desired to see these loopholes closed to "level the playing field."

As such, agriculture conflated to become the single most important issue, putting on hold the bulk of the remaining Uruguay issues. *Quid pro quo* linkages were established to bring more pressure to bear on the agriculture talks with details of non-agriculture disciplines and services awaiting conclusion of the Agreement on Agriculture.

The Uruguay Round was to have concluded in 1990 with a ministerial in Brussels, but agreement on agriculture could not be reached until nearly two years later in December 1992 when the United States and the European Union reached the "Blair House" breakthrough. After the stalemate on agriculture was broken, negotiations on the

[50] Crowley, 2003. 43-44.

remaining issues could move forward; a process that took another year and a half.[51] The Uruguay Round was finally concluded in Marrakesh, Morocco on 15 April 1994 with the agreements coming into effect—and the WTO coming into being—in January 1995.

The Agreement on Agriculture called for the following reductions in agriculture:

Numerical targets for agriculture
The reductions in agricultural subsidies and protection agreed in the Uruguay Round.
Only the figures for cutting export subsidies appear in the agreement.

	Developed countries 6 years: 1995–2000	Developing countries 10 years: 1995–2004
Tariffs		
average cut for all agricultural products	–36%	–24%
minimum cut per product	–15%	–10%
Domestic support		
total AMS cuts for sector (base period: 1986–88)	–20%	–13%
Exports		
value of subsidies	–36%	–24%
subsidized quantities (base period: 1986–90)	–21%	–14%

Least-developed countries do not have to make commitments to reduce tariffs or subsidies.

The base level for tariff cuts was the bound rate before 1 January 1995; or, for unbound tariffs, the actual rate charged in September 1986 when the Uruguay Round began.

The other figures were targets used to calculate countries' legally-binding "schedules" of commitments.

Table 1. Numerical Targets for Agriculture[52]

After the envisioned four-year negotiating round was concluded in eight years, many nations recognized that negotiating fatigue had set in and many experts questioned whether another vast multilateral treaty could ever be successfully concluded. Despite the evident fatigue, however, the Uruguay Round had a built-in agenda calling for subsequent negotiations and by 1996 some nations were calling for a new round of negotiations to begin at the turn of the century.[53]

51 Robert Paarlberg, "Agricultural Policy Reform and the Uruguay Round: Synergistic Linkage in a Two-Level Game?" *International Organization,* Vol. 51, No. 3 (Summer 1997), 414.

52 Table is reproduced from "Understanding the WTO," at: http://www.wto.org/english/thewto_e/whatis_e/tif_e/tif_e.htm accessed December 2005, 28.

53 "Understanding the WTO," 2005, 19.

The pre-Uruguayan Round GATT largely dealt with tariffs on manufactured goods. As these tariffs were successfully negotiated down over the years, attention was turned to the "trade-impeding effects of nontariff barriers and domestic regulatory regimes."[54] The broadened scope of the Uruguay Round topics and the evolution of the GATT into the WTO reflect this expanding scope of international trade issues which some have called the 'new trade agenda'. The 1999 trade ministerial in Seattle, Washington saw this inclusionary trade-topic trend coupled with embittered North-South or Developed-Developing Nation tension. Amidst this backdrop of protest and antagonistic finger-pointing, the ministerial unsurprisingly failed to initiate a new round of multilateral trade negotiations. At the next ministerial—the Fourth, held in Doha, Qatar, in November 2001—the issues of developing nations were at the forefront and a new round of negotiations was launched along with the Doha Development Agenda, specifically geared towards addressing the issues of developing nations capacity to implement and take advantage of the benefits of free-trade.

The Fifth Ministerial Conference was held in Cancún, Mexico in September 2003 and the topics of trade-*un*related matters and agriculture again, caused the negotiations to fail. These issues, that were peripherally trade related, were coined the "Singapore issues" and they were investment, competition policy, transparency in government procurement and trade facilitation. These were issues almost exclusively championed by the developed nations. The developing nations were intensely interested in achieving genuine market access for agriculture since this sector was considered a crucial engine to economic progress. The United States and EU signed a Joint Proposal one month before the Cancún ministerial defending farm subsidies that caused intense opposition by the Group of Twenty-One (G21) headed by some of the major developing nations of Brazil, India, China, South Africa, and Egypt to organize opposition and demand agricultural

[54] Bernard Hockman and Kym Anderson, "Developing-Country Agriculture and the New Trade Agenda," *Economic Development and Cultural Change*, Vol. 49, No. 1 (Oct 2000), 173.

reform55: "…22 developing nations, lead by Brazil, China and India, stood together and refused to consider any other trade issues until the Big Four [United States, EU, Japan, and Canada—also called The Quad] agreed to reduce the massive subsidies they pay their own farmers."[56] This impasse was not broken until mid-2004 when General Council meetings resulted in a framework that came to be called the July package. This agreement consisted of elimination of export subsidies and substantial reduction for trade-distorting domestic subsidies, among other items.[57]

B. KEY PROBLEMS – INTERNATIONAL LEVEL

1. Linkages

Just as in the Uruguay Round negotiations over agriculture, the battle lines have formed with *quid pro quo* linkages being established. Just like in FTAA—Free Trade Area of the Americas—negotiations, where the United States must concede genuine access to competitive agricultural imports in order to "buy" manufacturing, investment, and services access, as well as IPR protection. The G21 has made it clear that in order for the developed world to gain that access in manufacturing and services it must eliminate trade-distorting agricultural policies. These linkages—or cross sector trade-offs—are intended to bring pressure to bear on both the negotiators at the international level as well as constituents and lobbyists at the domestic level. At the international level these positive linkages serve to raise the stakes of the negotiation. Given that the WTO negotiation is a 'single undertaking'—meaning that every nation must sign off on every part of the deal before it is accepted—by linking important issues, it becomes much more difficult for negotiators to walk away from the table at an impasse. The pressure to gain

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[55] The G21 was formed by the Cairns Group and some other developing nations in response to the entrenched position taken by the United States and EU regarding domestic support, market access, and export competition at the Montreal WTO mini-ministerial. The G21 has included up to 24 nations and has been referred to as the G20, G21, and G22 at various times. The 24 nations are: Argentina, Brazil, Bolivia, Chile, China, Colombia, Costa Rica, Cuba, Ecuador, Egypt, El Salvador, Guatemala, India, Indonesia, Mexico, Nigeria, Pakistan, Paraguay, Peru, Philippines, South Africa, Thailand, Turkey, and Venezuela. Source: Imtiaz Hussain, "After Cancún: G21, WTO, and Multilateralism," *Journal of International and Area Studies*, Vol. 11, No. 2, 2004, 9-10.

[56] Stephen Hesse, "Poor Farmers Pay Price for Subsidies," *The Japan Times* at: http://www.japantimes.co.jp/cgi-bin/makeprfy.p15?fe20031113sh.htm accessed December 2005.

[57] "Understanding the WTO," 2005, 80.

the collective returns of linked issues keeps the trade negotiators working and, hopefully, fosters more of an attitude of compromise.

At the domestic level two things are happening. First, when an agreement is reached at the international level that *de facto* puts pressure to honor the established agreement at the domestic level—this is Putman's synergistic linkage[58] Second, by identifying specific sectors whose gains are tied to successful agricultural negotiation, a set of winners with incentive to organize and advocate for agricultural reform is created. If agricultural reform were to occur unilaterally the winners would be the entire food-buying population of the United States who would see greater variety and lower prices as a result of genuine competition. The winners are, therefore, an incredibly broad and diffuse group whose individual members stand to gain a small incremental improvement. The size of this improvement to each individual in most cases does not provide sufficient incentive to advocate against well organized and well financed lobbying machines. The losers, however, are a small, concentrated group that is and has been motivated to organize and advocate for continued protectionist policies. It's only natural that their incentive is for continued subsidization since that means guaranteed money and a shelter from the vagaries of free-market competition. These positive linkages create incentive for other sectors to advocate *for* reform so that the broad, diffuse set of winners gets informed and hears a different viewpoint than the agricultural lobby's and political pressure can be brought to bear to make a decision for the greater collective good. The fact that fully nine-tenths of the world trade occurs in industrial and service markets, where protectionist policies of this degree would be decried, shows both the benefit of establishing these linkages in negotiation as well as the deep-seated strength and durability of domestic agricultural lobbies.[59]

Consideration of 'this for that'—*quid pro quo*—must first entail honest assessment of the 'this'. While many have championed the agricultural reductions achieved in the Uruguay Round as a breakthrough, the reality may have been more one of posturing and 'smoke and mirrors'—a phrase that is often utilized today by developing

58 Putman, 1988, 460.

59 Juliane von Reppert-Bismarck, "EU Rebuffs France, Backs Trade Chief," *The Wall Street Journal* (Eastern edition), New York, N.Y., 19 October 2005, A 11.

nations to characterize the rich industrialized countries' current offers for reductions in trade-distorting agricultural policies. President Reagan entered the agricultural negotiations with the following mindset: "No nation can unilaterally abandon current policies without being devastated by the policies of other countries. The only hope is for a major international agreement that commits everyone to the same actions and timetable."[60] With this, the U.S. negotiators introduced the "Zero-Option" in 1987 calling for phased lowering of all trade-distorting subsidies to zero over a ten year period. The EU, specifically France, has historically employed much greater protectionism for its agriculture than the United States has. As such, the Zero Option was not acceptable to them. The numbers that were ultimately arrived at for tariff reduction (see Table 1, above) were, in fact, the results of unilateral calculations based on domestic issues where the reductions had either already occurred or were already planned. In addition to this, the baseline maximum tariffs from which the reductions were a percentage of were carefully selected so as to represent very high allowable limits. In many cases, these limits had been intentionally increased by domestic legislatures in anticipation of future reductions—arming to disarm.[61] The result was that the 'breakthrough' in agriculture meant that neither the United States nor the EU had to make any reduction whatsoever in actual applied tariffs and the most important subsidies had been specifically excluded from the agreement—the U.S. deficiency payments to farmers and EU compensation payment, both large domestic cash subsidy programs that created incentive to overproduce.[62]

A large part of the reason developing nations came to Seattle and Cancún ready for a fight was the perception that they had made concessions in market access for manufactured goods and services but had gained nothing in return.[63] Instead they faced business as usual protectionist policies from the huge markets that they specifically needed to gain access to for sustained economic growth. It is this perception that has led

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[60] Paarlberg, 1997, 420-421.

[61] Paarlberg, 1997, 423.

[62] Paarlberg, 1997, 428.

[63] Robert Looney, "The Cancun Conundrum: What Future for the World Trade Organization (WTO)?," *Strategic Insight*, Vol. 2, No. 10, October 2003 at: http://www.ccc.nps.navy.mil/si/oct03/trade.asp accessed December 2005.

many critics to characterize the current proposals for agricultural reform as ‘smoke and mirrors’ and unless huge percentage reductions are agreed upon, this may be the case.

> For Example, the United States proposes to lower the World Trade Organization cap on production-linked subsidies for American farmers by 60 percent, an apparently bold measure. But the cap is so high that the United States could accept a cut of about 25 percent without reducing its actual payments at all. And a complicated loophole allows it to accept a further cut of about 25 percent without reducing the real level of protectionism. So unless the proposed cut is more than 50 percent, it may not be worth having.[64]

2. What’s Wrong with Protection of Agriculture?

The EU’s Common Agricultural Policy (CAP) “was born in the postwar years, when food aplenty in Europe was not a given. Its aims were to guarantee supplies and subsistence levels for farmers and to slow down flight to the cities.”[65] The United States has also had a long history of protectionist policies in many sectors. Most of the other sectors have been reduced, leaving agriculture as the anachronism that distorts global trade to the detriment of all.[66] Here’s what some others have said about tariffs and subsidies:

- “Every cow in the European Union receives more money than the daily income of the average African”—Bob Geldof[67]
- “Distortions in agricultural trade not only harm efficient exporters by denying them market opportunities. Domestic and export subsidies in developed countries depress prices and incomes throughout the world, cut into export earnings and increase food insecurity in developing countries”—Celso Amorim, Brazilian Foreign Minister[68]

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64 “Waking Up to Trade,” *The Washington Post*, Washington, D.C., 13 October 2005, A 22.

65 Anonymous, “Farm Subsidies that Starve the World,” *New Statesman*, Vol. 18, No. 864, 20 June 2005, 6.

66 The steel industry stands out as a significant exception but it has recently been handed defeat in the WTO dispute resolution process being found as too protectionist.

67 Anonymous, 2005, 6.

68 Celso Amorim, “The Real Cancun,” *The Wall Street Journal* (Eastern edition), New York, N.Y., 25 September 2003, A 18.

- "Vicious, inequitable, and illogical source of unnecessary taxation…which imposes a burden upon those who consume domestic products as well as those who consume imported articles, and thus creates a tax on all the people"—Grover Cleveland, 22nd and 24th President of the United States (1885-1889 and 1893-1897)[69]

The prevalent distortion that occurs when producers are protected or subsidized is overproduction. If tariffs are too high or tariff-rate quota[70] levels are too low, then domestic producers are protected from competition. This keeps the supply on the domestic market artificially low and the price correspondingly high so that domestic consumers bear the burden. In essence, that domestic crop has imposed a tax on their own consumers at home, frequently a very high tax. Sugar serves as a perfect example where U.S. prices for sugar are more than two times the world market level—that makes the domestic "tax" over 100%. Exporting nations are hurt as well by this since they cannot get access to a large market. The demand is, therefore, kept artificially low for these nations resulting in depressed prices and lost revenue.

Another distortion leading to overproduction occurs from direct support—cash payments—or export subsidies—a form of minimum price guarantee. This insulates the producer from any sort of price-driven demand signal. The price is at a fixed value—an inflated value—and the incentive is for the producer to grow as much of that crop as is possible. This leads to excessive supply on the global market which also serves to artificially keep prices down globally and results in lost revenue for other would-be producers of these crops. Here the sheer size of the U.S. (or EU) economy factors in where productive capacity is sufficient to affect global price and the dollar amount that the United States is able to subsidize certain sectors which exceeds any developing nations' ability to compete.

The primary justifications for protecting farmers despite these distortions are to ensure adequate food supply, preserve rural society, and to shelter farmers from the

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69 Richard W. Fisher, "Protect Us From Protectionists," *The Wall Street Journal* (Eastern edition), New York, N.Y., 25 April 2005, A 14.

70 The quantity of in imported product that triggers punitive tariff levels.

cyclical effects of weather and world market fluctuations.[71] When this issue is debated on the domestic front, images of small-town farmers fighting for their rustic way of life abound, but the reality is that 75 percent of the U.S. agricultural support goes to only 10% of the farmers. These are not the small-town mom and pop farming families; these are the big agri-business conglomerates that have succeeded in virtually cornering the market on a rent-producing crop.[72] Sugar again serves as a good example of the inefficiencies introduced when producers are shielded from competition. Sugar beet growers comprise "one of the most formidable political forces in American agriculture," yet sugar beets are an inefficient way to produce sugar; the rule of thumb is that cane is two times more efficient than beets.[73] Another rent-producing crop in the United States is cotton. In 2003, the industry received 3.9 billion dollars in subsidies for only 3.0 billion dollars worth of crops—that's a 30 percent "tax" imposed on cotton. What's more, there are only 25,000 cotton producers in the United States; 3.9 billion dollars for 25,000 producers comes out to $156,000 per producer in support alone.[74] Finally, the 2004-05 forecast for cotton exports globally indicates that the United States is expected to export fully four times more tonnage of cotton then the global second-place exporter.[75] Any nation that has the capacity to produce—outproduce—on that kind of scale can hold its own in a competitive market.

As significant as the effects from U.S. agricultural policy are on global trade in agriculture, the EU and Japan protect their farmers to a much larger degree. Where U.S. sugar prices are two times the world market level, EU sugar prices are three times that level.[76] In 2001, the United States provided just over 49 billion dollars for subsidies and both import and export tariffs. Taking into account the volume of agricultural goods traded, this represented a 15 percent distortion. In that same year the EU provided just

[71] "Understanding the WTO," 2005, 29.

[72] Hesse, 2003.

[73] Paul Blustein, "A Bitter Pill for Sugar Beet Farmers; Powerful Lobby Takes Aim at President Bush's Proposed Trade Pact," *The Washington Post*, Washington, D.C., 7 June 2005, D 1.

[74] Hussain, 2004, 5.

[75] United States is expected to export 2,918 thousand metric tons while Uzbekistan, in second place, will export 729 thousand metric tons. Source: Jerry Hirsch, "Trade Battle With Brazil Threatens U.S. Copyrights; Brasilia Weighs Halting Intellectual Property Protection to get U.S. to Curb Cotton Subsidies," *The Los Angeles Times*, Los Angeles, California, 10 June 2005, C 1.

[76] Anonymous, 2005, 7.

over 93 billion dollars which represented a 33 percent distortion and Japan provided over 47 billion dollars in support which represented a 136% distortion.[77]

Taken as a whole, "the industrialized world spends $1 billion a day on agricultural subsidies."[78] The consequence of this has been estimated by the World Bank and others to represent close to a half-trillion dollars per year in static welfare gains that could be realized with the removal of trade barriers of which the developing world would garner between one-third and one-half of these gains.[79]

The ironic losers are the domestic consumers that have to support rent-seeking agricultural sectors but they are diffuse and only lose a very little….not enough to organize and speak out. Internationalization and linkages create the incentives for the trade-off losers to speak up and counter-balance the very organized and very influential rent-seekers who desire to maintain the status quo. One of the second order effects to the United States has been the halting of negotiations on the Free Trade Area of the Americas. The reservation by Venezuela and the four full Mercosur nations at the Fifth Summit of the Americas in Mara del Plata, Argentina in November 2005 stated that, "The conditions do not exist to attain a hemispheric free trade accord that is balanced and fair with access to markets that is free of subsidies and distorting practices."[80] Somewhat more abstract but also more dire is the comment from Robert Zoellick, the former U.S. Trade Representative: "people in Latin America, Africa, and Asia want to sell their products to developed countries. If three major continents—encompassing some five billion people—cannot prosper, we will all pay the price."[81]

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[77] The dollar amount is an indicator of the annual monetary value of gross transfers from consumers and taxpayers to agricultural producers. The distortion is a ratio between the average price received by producers and the border price. Source: Hans Peter Lankes, "Market Access for Developing Countries," *Finance and Development*, Vol. 39, No. 3, September 2002 at: http://www.imf.org/external/pubs/ft/fandd/2002/09/lankes.htm accessed December 2005.

[78] Looney, 2003.

[79] McGuirk, 2002.

[80] Marcela Valente, "Americas: U.S. Free-Trade Zone Proposal Flops at Summit," *Global Information Network*, New York, 7 November 2005, 1.

[81] Robert Zoellick, "Committed in Cancun," *The Wall Street Journal* (Eastern edition), New York, N.Y., 8 September 2003, A 16.

C. POLITICAL ECONOMY ANALYSIS – INTERNATIONAL LEVEL

Having laid out all the requisite background information, the political economy analysis will be a straight-forward assessment identifying the players and their goals, the players' policy preferences, the groupings that occur, and the institutional interactions.

1. Actors and their Goals

Given the fact that the WTO is comprised of 149 member nations, the list of players and the diversity in goals is large. The list of predominant players surrounding the issue of agricultural reform is somewhat smaller and can generally be grouped into nations with the goal of drastically lowering agricultural support and those with the goal of preserving the status quo—or at least as much protection as is possible. From the point of view of the United States, the market that must match our reductions in protection in order to assure market access for our newly unprotected domestic agricultural sectors is the EU. Therefore, for simplification sake, we will narrow the scope to reduction in agricultural support in the United States and the EU. As mentioned, Japan has significant protectionist policies—that have created even larger distortions than have the western industrialized nations—with substantial impact in the Western Pacific and Asia. While there is no way to be certain, it appears that Japan is willing to conform to reciprocated reductions in protectionist policies. The negotiating protagonists, therefore, are the EU—France specifically—and the United States—with the significant partnership of the G-20 and the Cairns group supporting reduction in domestic subsidies; reduction in all trade distorting practices.

In defense of protectionism is the EU with France leading the call for maintaining the status quo. On the opposite side of the issue stands the United States with President Bush announcing that "The United States is ready to eliminate tariffs, subsidies and other barriers to free flow of goods and services as other nations do the same."[82] Also supporting reduction in trade-distorting protection are most of the developing nations, significantly: Brazil and India leading the G21; and Australia and Canada leading the

[82] Andrews, 2005.

fifteen member Cairns Group.[83] Notably, China is largely silent on this issue although the United States is urging them to step up to the table and participate. The nations on either side of this issue represent the overwhelming majority of global trade with most of them standing on the opposite side of the table from the EU, with the stipulated exception of Japan and the noted abstention of China—whose two nations represent a not inconsiderable amount of international commerce.

2. Policy Preferences

If we placed all the countries on a linear continuum of preference for retaining protection, France would anchor the far left end of this line with the strongest desire to retain protection. On the far right of this line would be Australia and many of its Cairns Group members with their call to allow "market forces to be the main determinant of agricultural trade flows."[84] Not far from Australia would be the United States with its calls for complete elimination of export subsidies and up to a 90 percent reduction in all tariffs and a 60 percent reduction in subsidies with the remaining being decoupled subsidies for sensitive sectors—decoupled subsidies are cash payments that are structured so that there is no incentive for overproduction and are, therefore, not trade distorting.[85] In the middle would be some of the G21 members and many other developing nations. The reality is that many of the developing nations feel that the rich countries should lower protections to provide increased market access for the developing nations but that these nations should maintain their own protection against floods of cheap merchandise from the large industrialized nations. The problem with this approach is that some of the highest tariffs exist between developing nations, with rates upwards of 70 percent.[86] Much of that half-trillion static welfare that the World Bank estimated would accrue to

[83] The Cairns Group consists of 15 agricultural exporting countries: Argentina, Australia, Brazil, Canada, Chile, Colombia, Fiji, Indonesia, Malaysia, New Zealand, Paraguay, Philippines, South Africa, Thailand, and Uruguay. Nine of these nations are also in the G21—all but Australia, Canada, Fiji, Malaysia, New Zealand, and Uruguay.

[84] P. Lynn Kennedy, Won W. Koo, and Mary A. Marchant, "Key Issues and Challenges for the 1999 World Trade Organization Agriculture Round," *American Journal of Agricultural Economics*, Vol. 81, No. 5, Proceedings Issue (December 1999), 1134-1141.

[85] Scott Miller and Greg Hitt, "U.S. Prepares To Compromise On Farm Tariffs; New Trade Proposals Aim To Resolve EU Disputes Following Months of Talks," *The Wall Street Journal* (Eastern edition), New York, N.Y., 10 October 2005, A 11.

[86] Zoellick, 2003.

developing nations comes only with the reduction of their own tariffs and a dramatic increase of inter-developing nation trade.

There also exists some issue asymmetry within the ‘organized’ groups, specifically the G21 and the EU. The two apparent leaders of the G21, India and Brazil, have quite different policy preferences. Brazil is much more offensive minded and wants to see wholesale dismantling of trade barriers to agriculture so that it can export its own goods to the gigantic U.S. market. India, on the other hand, is much more defensive minded and wants to protect its own cotton industry from the unfair practices of the United States. As stated previously, China is a conspicuously silent member of the G21 and is regarded as business-like which means that they’ll make a decision based on the actual details of any proposed agreement.[87] Within the EU, Britain has lamented the amount of the EU budget that is allocated to the CAP and would like to see more attention paid to manufacturing and services, the sectors that it—and other EU nations—see as the EU’s true competitive advantage.[88] Before we begin claiming the disintegration of the EU from within, however, we need to take into account the fact that many of the other EU nations are unwilling to reduce agricultural protection but are silently letting France take the point on the issue. Specifically, Germany is dependant on subsidized Bavarian farmers for domestic political support and Poland’s government relies on domestic support from farmers. Additionally, Spain, Italy and Hungary are not far from France’s position and may quickly side against any WTO negotiation concessions depending on the details.[89]

Unsurprisingly, therefore, the policy preferences are inter-related and complicated. On the simplest and largest issue, the battle lines are fairly clean on whether the large industrialized nations—specifically the United States and EU—should

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[87] Hussain, 2004, 4.

[88] Reppert-Bismarck, 2005.

[89] Bruce Stokes, “Limping Toward Hong Kong,” *National Journal*, Vol. 37, No. 47/48, 19 November 2005, 3655.

dramatically reduce and/or eliminate trade-distorting agricultural policies. Beyond that, however, nation's self-help instincts take equal measure in consideration of policy preference.[90]

3. Groupings

Given that there are 149 nations in the WTO, groupings are natural occurrences as nations gravitate over common issues or circumstances. The four industrialized nations with the largest agricultural exports are called the Quad and they are the United States, EU, Canada, and Japan. As discussed in the policy preference section, these nations are not standing united on the issue of agricultural reform. Cancún, and the lead up to that ministerial, saw the formation of several groups uniting on agricultural policy preferences. The Cairns Group formed prior to Cancún at the Montreal mini-ministerial and the G20 (they became the G21 in September) formed in response to the Joint Proposal adopted by the United States and EU one month before Cancún. While debate intensified over agriculture and the Singapore issues several African and Asian nations formed the G90—Group of Ninety—staunchly in opposition to the Singapore issues. The G90 is only relevant to this discussion in its contribution to the failed Cancún ministerial with the shadow that failure is casting on the impending Hong Kong ministerial.

The relevant groupings over the central issue become the United States with the Cairns Group and the G21 calling for agricultural liberalization with the EU in opposition. Smaller, temporary, groupings occur frequently over various specific agricultural issues. For example, India and several African nations united to challenge the U.S. cotton policies—and won a favorable ruling in the WTO dispute resolution process. Also, Australia, Brazil, Thailand and the United States joined against the EU's sugar policies.[91]

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[90] Hussain, 2004, 4.

[91] Hussain, 2004, 4.

4. Institutional Interactions

Clearly the predominant institutional setting is the WTO with all attention on the recently completed Hong Kong ministerial. The initial verdict on the Hong Kong ministerial is guarded success. While some characterized the outcome as "short on deliverables and long on intent"[92] some progress was made. As predicted, the antagonists were the United States and the G-20 aligned against France and the EU with the United States calling for elimination of export subsidies by 2010. The EU response was an agreement to eliminate them by 2013—when the current CAP allows agricultural reform. With this compromise agreement, failure of the ministerial was averted and discussions continue with a deadline of 30 April 2006 for concluding modalities. The difficulty lies in the potential outcome where the EU proposed cuts really are smoke and mirrors. That is to say, they are such modest percentage reductions of high allowable caps that they represent no real reduction in applied policies. It is impossible to ignore interactions at the other levels of this game, however. Domestic politics are deeply tied to the issue of agricultural policy and it is frankly unknown if any amount of synergistic linkage can overcome this immensely powerful domestic lobby in either the United States or the EU nations of France, Germany, and Poland.

The Cairns Group's most important agenda was the elimination of export subsidies and, by and large, it looks as if those will be phased out. The outcome remains unclear on tariffs (both level of tariff and tariff-rate quotas) and direct subsidies. It is clear that some percentage reduction will occur in tariffs. The horse-trading is over just how big of a reduction. Unfortunately, it does not appear as if even a framework has yet been agreed upon for dismantling or restructuring direct subsidies. The end of April will yield a clearer picture of the status of these critical subsidies.

The implications of the international level are, therefore, unclear for the FTAA. If the WTO negotiations are somehow able to progress significantly in the next few months then sufficient reciprocated reduction may be achieved to allow FTAA negotiations to pick back up. Given the historic pace of WTO negotiations coupled with the sensitivity of this issue, however, that must be viewed as an optimistic outcome.

[92] Malini Bhupta, *Business Today*, 29 January 2006, 56.

Another significant interaction occurs in the U.S. Congress. Two extremely important items will be legislated within that body in 2007 and this fact puts a firm deadline on the Doha Agenda. President Bush's Trade Promotion Authority (TPA or 'fast-track') will expire in 2007 and the prevailing opinion is that TPA can not be approved in a contentious election year with the next administration not yet identified.[93] Also, the next U.S. Farm Bill will be legislated in 2007 and this creates tension between the international level negotiations and the domestic level arena that is the prerogative of the U.S. Congress. The Chairmen of both the Senate and House agriculture committees have warned the U.S. Trade Representative, Rob Porter, "not to adopt positions that preempt Congress's authority to write the next farm bill,"[94] On a more optimistic note, U.S. Senator Chambliss, the chairman of the Senate agricultural committee, did echo President Bush's challenge for other nations to meet the proposed U.S. cuts with cuts of their own.[95] The immediate impact on these negotiations is that an agreement must be finalized by the end of 2006 so that it can be approved in the U.S. Congress before President Bush's TPA expires in 2007. In order to meet that aggressive timeline a firm framework needed to be in place prior to the Hong Kong ministerial and that did not occur. It remains to be seen if the April deadline will result in sufficiently quick negotiations.

Success or failure of the WTO itself as a legitimate global trade regulating body rested on the outcome of these negotiations over agricultural policy. The battle lines were drawn, the linkages (*quid pro quos*) were established, and the real horse-trading was—and still is—left. The norm for WTO negotiations, particularly over hotly contested issues, is one of missed deadlines and taking longer than anticipated. The Uruguay Round took an additional two years (from 1990-1992) to work out agricultural issues and was not signed until 1994 after the non-agricultural market access issues were concluded. These linked items could not be negotiated until agriculture was resolved. If, and that is a very large IF, a substantial agreement can be negotiated on agriculture, the enormous volume of horse-trading then really just gets going on services and

93 After all who can guarantee the pork until they're elected? Cynical but true.

94 "Waking up to Trade," 2005.

95 Alexei Barrionuevo and Tom Wright, "Europe Entertains an American Offer to Cut Farm Aid," The New York Times (Late Edition (East Coast)), New York, N.Y., 11 October 2005, C 1.

manufacturing. In light of this, the realistic expectation of completing negotiations in the next calendar year when the positions are entrenching so that U.S. ratification can occur prior to the expiration of TPA is unrealistic.

Nonetheless, the future of the WTO rests on it. Similarly, the fate of the FTAA rests on it. If some watered down agreement is reached that spares the WTO, it may be insufficient for Brazil and other Latin American members of both the Cairns Group and the G21 to be willing to "give" on IPR, manufacturing, and services. Despite the fact that the United States and Brazil are on the same side of the table against France, the rest of the EU, and Japan in the WTO negotiations, when those negotiations conclude they must go to opposite sides of the table to conclude (or even determine if negotiations can continue) discussion on any future FTAA.

To say that the outcome of these WTO negotiations is significant would be an understatement. The global trading world is at a crossroads where one path will change the way nations do business and pull the nations of the world tighter as barriers between trading partners fall. The other path results in business as usual with the rich industrialized nations who champion free-markets and liberal ideals hypocritically telling the developing world that they should do as they say and not as they do. In a refreshing reversal the United States is championing the case for the developing world but if France and the EU are able to scuttle the negotiations then the United States will quickly find itself on the receiving end of harsh demands and criticism from its Latin American neighbors. Furthermore, the United States can forget about any hemispheric wide FTAA if it is unable to provide genuine market access in agricultural—something it has repeatedly stated it cannot do unilaterally.

D. IMPLICATIONS – INTERNATIONAL LEVEL

Figure 4 depicts France's and the United States' positions on multilateral reductions of domestic subsidies. The U.S. preference line is relatively wide indicating that they'll accept a reduction at almost any level but has a higher preference for greater reductions up to 90%. The French curve, on the other hand, indicates an entrenched position and intolerance for reductions much above 35-40%. As the figure indicates,

agreement is possible but it will be at a level of reduction dictated by France. That level will be too small of a reduction given the large allowable limits. The net result will yield no genuine increased access to the developing nations and will, therefore, not provide incentive for Brazil to make negotiating concessions on services, government procurement, or protection of investment or intellectual property.

Negotiating energy will continue to be spent trying to influence France –and, therefore, the EU—to flatten out its interest line to accept a higher level of reduction.

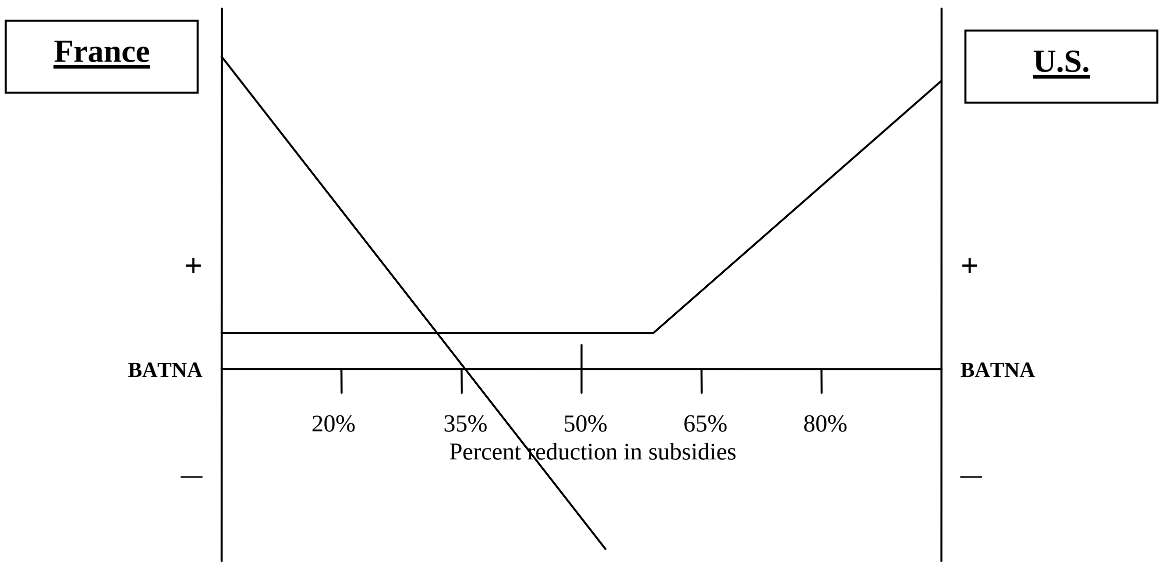

Figure 4. International BATNA Diagram

The implication of the international level findings to the FTAA is not that reductions will not or cannot happen but, rather, that sufficiently large reductions will not happen soon enough to permit successful conclusion of the FTAA with Brazil and the United States "meeting in the middle" of both sufficient reductions in protection and increased access and protection.

It can clearly be seen that domestic subsidies is the single most important issue facing the WTO with all of the global traders having a vested interest. It can also be seen

that a large amount of work remains to be done before any agreement is reached at the international level, with the ultimate outcome in doubt. This uncertainty, coupled with the deadlines imposed by the U.S. domestic level make it very likely that no agreement can be reached in time to successfully conclude FTAA negotiations *after* WTO negotiations. The likelihood of completely successful negotiations at the end of April at the WTO level followed by the myriad of issues to be hammered out at the regional level is very slim. It is the tension created at the domestic level with the deadlines imposed by TPA expiration and the upcoming Farm Bill that shadows the success of the FTAA. It is important, therefore, to better understand these issues at home in the United States.

IV. U.S. DOMESTIC ANALYSIS

> Politicians love to ask, How many jobs will be gained by a trade agreement? And senior government officials and other bureaucrats who deal with trade will provide an inane answer. This calculation, however, should not be confused with reality.

—Sidney Weintraub, Director of the Americas program at the Center for Strategic and International Studies, February 2005.

A. INTRODUCTION – DOMESTIC LEVEL

We've already discussed the battleground issues at the heart of reaching an FTAA and have identified the singular importance of domestic subsidies in that debate. We've also looked at the issues surrounding multilateral subsidy reductions and the difficulties at the present time in convincing France and the rest of the EU to accept meaningful cuts in domestic support. With our pessimistic determination that multilateral negotiations are unlikely to yield sufficient reciprocated reductions in domestic subsidies, we will examine the domestic level to see if the United States can provide these necessary reductions in the face of failure at the WTO negotiation—or, perhaps, too slow progress in those negotiations.

Subsidies represent an intentional shift of resources away from the ones identified strictly by the market mechanisms as successfully competitive. These decisions are almost always a social decision to prioritize some sensitive sector above its "natural" free-market station to guarantee the continuation of this sector for a wide variety of reasons. For the recipients of this support, subsidies represent a rent that they accrue by virtue of participating in that sector—sugar beet growing, for example. The incentive provided by a rent is a very straight forward and powerful motivation. The rent-earners have every incentive to protect that income stream. As such, these decisions are highly political ones and will alter the focus of political economy analysis more heavily towards the political side. That is to say, there is a fairly clear argument in strictly economic terms about the detriment of subsidies. The political equation, however, is much more complicated and pits rent-seekers that are intensely aware of what they stand to lose

against this broad diffuse group of consumers that are not necessarily aware of what they stand to gain. Furthermore, even when some of these consumers are aware of these gains, they may prefer to forego those consumer gains in order to avoid inflicting losses on a clearly identified group. Said another way, when the consumers are given a choice for better selection and lower prices without clearly identified losers, the decision is a no-brainer, but when they are aware of some specific group of losers—dairy farmers in Pennsylvania, for example—these consumers may decide that getting their milk for five or ten cents less per gallon isn't worth the pain and suffering that they would be inflicting upon the losers that successful lobbyist had identified as "poor Pennsylvania farmers" trying to preserve some perceived historic pastoral way of life that is, in reality, far different from the way of life of most Americans and, to be honest, quite different from the reality of most farming today in the age of large commercial agro-business producers who receive most of the subsidies. [96]

B. KEY PROBLEMS – DOMESTIC LEVEL

Two other significant domestic issues weigh heavily on both the multilateral negotiations at the WTO level and the regional negotiations at the FTAA level and they are: Trade Promotion Authority—or "Fast Track"—and the U.S. Farm Bill. Both of these issues come up for congressional consideration in 2007.

Trade Promotion Authority gives the President the ability to present a negotiated trade deal to Congress for ratification that cannot be modified by that body. They must give it either an up or down vote. This authority gives the President the ability to negotiate a deal that the other parties to the negotiation can trust to not be modified or altered by the U.S. Congress. More importantly, TPA gives credibility to the U.S. negotiators because the Congress has already demonstrated some assent for future trade deals by giving that negotiating latitude to the executive Trade Representative. In essence, TPA allows the negotiators to actually speak for the country—subject to ultimate approval from Congress in the form of ratification. In the absence of TPA, other nation's negotiators—Celso Amorim from Brazil, for example—realize that any terms

[96] Cletus C. Coughlin, "The Controversy Over Free Trade: The Gap Between Economists and the General Public," Federal Reserve Bank of St. Louis *Review*, January/February 2002, 1.

stipulated or agreed to in FTAA negotiations are subject to modification, often lengthy debate filled modifications, by the Congress and that anything agreed to with the negotiators is, most likely, not the actual end deal. This tremendously weakens the negotiating authority of the USTR and his team of experts. Everyone in the room knows ahead of time that the Congress is looking over their shoulders and that what they say does not necessarily go.

President George W. Bush gained a two year extension for TPA in 2005. That will expire, therefore, in 2007. Extensions are for two year periods and at that time, the President will only have one year left in office. It is unlikely that Congress will grant the next President a free year of TPA without knowing who that President is and what his trade ideas, philosophy, and agenda are. Furthermore, 2007 will see the beginning of the campaigning for both that presidential election and Congressional elections. It is unlikely that Congress will renew TPA in light of both of those upcoming electoral items in 2008. Whoever the newly elected President is in 2008 will have to gain TPA after he—or she—takes office. Taking into account the negotiating weakness that lack of TPA brings about; there is a firm deadline on this administration's ability to conclude any negotiated trade deals. If a deal—either at the WTO level or the FTAA level—cannot be concluded this year so that it can be presented for Congressional ratification in 2007 prior to TPA expiration or Farm Bill completion, then it is highly unlikely that any deal can be completed. If this deadline passes with no deal, then the likely outcome is that any real negotiation will cease until 2009 after the unknown next President gains TPA—if, that is, he is able to gain TPA. After the next President gains TPA, real negotiations can resume.

The next domestic item that is putting time pressure on negotiated trade deals is the upcoming U.S. Farm Bill. The current bill was enacted in 2002 and is a five year bill. That means that in addition to TPA expiring in 2007, the next Farm Bill will be enacted. That means that negotiations and political posturing are occurring right now for that upcoming bill. Furthermore, whatever subsidies are agreed to in that bill will be in effect for five years—until 2012. This timeline limits negotiators further in that, even if the subsequent President is able to gain TPA, they will not be able to negotiate any reduction in subsidies until that 2012 expiration of the 2007 Farm Bill. International negotiators will, therefore, know that any items being discussed in 2009 are no closer than three

years away and may, in fact, be much further if a phased reduction is agreed upon. This will dramatically reduce any urgency to agree to terms on any deal; be it WTO or FTAA.

To restate these time pressures, if a deal cannot be concluded this year for ratification in 2007, then negotiations will likely halt until 2009 and at that time, negotiations will be at the mercy of the 2007 Farm Bill terms. Congress and, more importantly, agricultural lobbies are equally aware of these time factors and will intensely strive to lock in favorable terms in that 2007 Farm Bill so as to forestall any possible reductions to no sooner than six years from now. This would be a tremendous victory for those agricultural lobbies and would seriously hurt the USTR credibility to negotiate market access—both agricultural as well as NAMA (Non-Agricultural Market Access). It would be difficult to overstate the importance of these domestic deadlines on trade negotiations. If tremendous progress is not made in this calendar year then significant trade liberalization is, very likely, kicked down the road three years for negotiation and six years until the *beginning* of implementation.

C. POLITICAL ECONOMY ANALYSIS – DOMESTIC LEVEL

Having laid out all the requisite background information, the political economy analysis will be a straight-forward assessment identifying the players and their goals, the players' policy preferences, the groupings that occur, and the institutional interactions.

1. Actors and their Goals

There are really four significant actors—groups of actors, really—orbiting the constellation of FTAA matters at the domestic level. They are: the Executive, the Congress, the lobbies, and the public. Of these, three are active. The Executive is leading the issue through international negotiations. The lobbyists are seeking to influence the outcome. Congress is the yes or no arbitrator—while TPA is in effect, that is. The last group, the consumers, are, more or less, passive on the issue but they are brought into the fray with each of the other three actors trying to win the war of images and public opinion.

The relevant Executive branch actors consist of the President himself and his agent, the USTR Rob Portman. Their goals include passage of these trade liberalization deals not only for the sake of the trade benefits but, also, for the sake of political influence. If the Executive champions free trade policies, like this one has championed reduction of multilateral domestic subsidies—with the complete elimination of export subsidies and dramatic reduction of direct domestic support—and is unable to deliver these policies then its political influence is weakened. Likewise, successful negotiation of this Executive's policies strengthens the administration's political influence in general. The Executive's goals are, therefore, to simultaneously achieve important trade liberalization while strengthening their own political standing.

The Congress is equally motivated to maintain or increase their political standing through successful implementation of their own initiatives or preferences. Determination of these preferences, however, requires a delicate balancing act between satisfying their own constituencies and weighing the greater good of the nation. They have a responsibility to have the nation's interests at heart but are elected—or not elected—by their local constituents. Trade Promotion Authority, specifically and intentionally keeps the Congress at arm's length during the negotiations, although they are—or should be—aware and kept informed of the process. After an agreement is reached at the international level, that deal is presented to the Congress in its final and complete form for a simple yes or no vote. While the vote itself of yes or no is simple, the process of determining policy preference and the sophisticated influence exerted on members of Congress to sway that vote is anything but simple. It is the essence of politics, but we will endeavor to constrain the discussion here to the immediate FTAA affects. Suffice it to say that Congress's goals are to maintain or strengthen their own political standing while achieving, simultaneously, the preferences of the nation and their own constituencies as best they are able to balance those preferences.

The lobby's goals are very narrowly defined and coincide precisely with their policy preferences. Their goals are, simply, to bring about the particular policy preferences of that lobby and significant resources are expended hiring the lobbyists to represent those preferences to all three of the other actors—the timeless game of garnering political influence in Washington with both the Executive and the Congress as

well as media and public relations campaigns in the battle of images to influence the last group. For example, the sugar beet lobby very narrowly focuses on maintaining or increasing direct support for sugar beet growers. They are not stuck in the middle like the Congress or the Executive having to balance the greater good between winners and losers. They have a very straight forward job of championing one specific set of individuals.

The public at large is far and away the largest group of actors in this arena but they are also the most indirectly involved and, perhaps, the quietest. The other groups will be working to influence this group to get them to support or advocate for their particular policy preferences. They form the large diffuse group of winners who stand to gain greater selection and lower prices as consumers in both domestic and imported goods. Simply stated, their income will go farther and their lives are, therefore, enriched. The magnitude of this improvement is, however, a small increment and may be insufficient to clarify this gain as an intended goal for this group of actors. Again, the other actors will be fighting the war of images to influence this group of consumers to adopt their particular preference as their goal. Until this battle of images in the media and political arenas really gets going, this group represents a large wildcard with undefined goals.

2. Policy Preferences

The Executive is charged with negotiating the treaties and agreements for this nation. As such, it is clear that the policy preferences of this administration are for increased global trade liberalization. The prosperity that economic growth brings is tied to this administration's message of democratic peace. As recently as January of this year, President Bush stated, in his State of the Union address:

> We will choose to build our prosperity by leading the world economy -- or shut ourselves off from trade and opportunity. In a complex and challenging time, the road of isolationism and protectionism may seem broad and inviting -- yet it ends in danger and decline.[97]

[97] George W. Bush, 2006 State of the Union Address, at: http://www.whitehouse.gov/stateoftheunion/2006/ accessed March 2006.

This is the same consistent message that this administration has enunciated since the events of 9/11 pushed President Bush off of his initial aims of domestic reform and brought matters of international leadership to the fore. More specifically regarding protectionism, the President said this:

> So we're seeing some old temptations return. Protectionists want to escape competition, pretending that we can keep our high standard of living while walling off our economy…. these are forms of economic retreat, and they lead in the same direction -- toward a stagnant and second-rate economy.[98]

Given the nature of the President's job he periodically has the opportunity and the responsibility to state his policy preferences, so it becomes fairly straight forward to capture these preferences here. Specifically regarding reduction of domestic subsidies, the United States, along with the G-20, was advocating for significant reductions as articulated in the preceding chapter. A successful free trade deal garners both the immediate trade benefits, the eventual second order cooperation effects, and, not the least consideration, demonstrates the clout and power of the Executive by succeeding in its own agenda. It is important to note that the expressed preference at both the regional and international levels is for reciprocated reductions in domestic protection. The United States was unwilling to reduce this protection for just the FTAA nations because of the detrimental impact of facing subsidized EU competition without equal protection for U.S. producers. The carrot that is offered to U.S. producers to accept the reduction in subsidies is increased access to large European and Asian markets. The United States has repeatedly stated that unilateral reduction was impossible.

The Congress' policy preference is frequently fragmented with individual Representatives and Senators having to determine between the relative goods to the nation and to their own constituencies. That being said, a congressman that goes against his constituents' desires for the greater good of the nation will, likely, not survive the next election. It is, therefore, the rare individual that will prioritize the greater public good at the expense of those he represents and his own career. With that understanding, the representatives of the heavy agriculture areas, by and large, will support subsidies. What remains to be seen is if the linkages mentioned in the previous chapter will be

98 Bush, 2006.

sufficient to motivate sectors like manufacturing and services in other regions to adequately influence those constituents to cause their representatives to support subsidy reduction. Likewise, the battle for images will play a large part in swaying constituents' preferences which, in turn, will affect Congress member's preferences. Given the nature of Congress' job, their preferences are largely determined by the slice of the public that they represent. Determining the outcome of this aggregation of preferences will be influenced heavily by the war of images in the public arena—which is, in turn, influenced by the messages of the Executive and the lobbies.

The lobbies, again, have a very straightforward set of preferences. As already discussed, the presence of existing subsidies provides the natural incentive to advocate for the continuation of those subsidies. Anyone who was given the option of having to work for all of their income or to, instead, work for only a portion of their income with the other part guaranteed by the U.S. government would easily opt for the guaranteed income stream. It is only the externalities in trade distortion that makes these items disadvantageous to the public at large. The specific agricultural lobbies' preferences are the continuation—or strengthening—of domestic support for that sector.

The public's preference in aggregate is not yet defined. The war of images in the mass media that immediately precedes Congressional ratification clarifies this preference. Portions of it are defined, and those portions are the heavy agricultural regions. The rest of the districts are the preferences that are at stake and are heavily courted by the Executive and the lobbies. Public polling does indicate some interesting details. Some have advocated that all that is needed is to educate the public on the benefits of free trade and inform them that, as consumers, they are the actual winners. If this is done then the currently uninformed public will become free-trade supporters. Polling has indicated that, "the general public is not as strongly in favor of reducing trade barriers as economists."[99] Furthermore, many hold the opinion that he winners of free trade are businesses and not consumers. This leads, by and large, to indifference as it is perceived that there are no real effects upon them as individuals. Taken a step further, many public arena debates characterize exports as good and imports as bad. Exports represent hard

[99] Coughlin, 2002, 1.

working U.S. producers succeeding in bringing their goods to market while imports represent the success of some other nation's workers succeeding in our markets to the detriment of our workers. The perceived outcome is that opening our markets to foreign competition leads to unemployed Americans. The actual economic studies show a slightly different outcome with, "The bottom line is that trade policy does affect the distribution of jobs, but is unlikely to affect substantially the net number of jobs."[100] Coupled with these perceptions is the necessity for what is perceived as a level playing field. Fair and unfair are descriptions that resonate with the public. These findings provide a glimpse into the enormous significance of the war of images that will be fought to influence the preferences of this group. The Executive and the districts influenced by linkages will be working to convince the public that free trade brings about the greater good and that they are, in fact, the winners while the lobbies and the districts influenced by agriculture will be working to convince the public that without this necessary protection an American way of life will perish and thousands of hard working farmers and ranchers will be cruelly put out of work.

The point here is that nothing has changed the basic soundness of the economic argument. In the absence of the political sensitivity of losers, it is a straight forward choice that trade liberalization is the greater good. The political sensitivity of specifically identified losers makes this reality much more speculative with the eventual outcome relying on the war of images to sway the public who, as constituents, sway Congress—and the Executive for that matter.

3. Groupings

The groupings are largely defined by the institutional structure of the actors themselves. The Executive and the Congress are groups unto themselves with heavily overlapped interactions including, but in no way limited to, trade matters. The lobbies are self-organized groups formed specifically for putting forward that groups goals in the form of policy preferences. One could say that lobby groups are the children—or parasites, depending on your point of view—of political economy groupings and interactions. Predominantly the losers are organized with a coherent, loud voice and

[100] Coughlin, 2002, 11-14.

iconic images to go along with them—most of the poignant imagery entails mom and pop down on the farm (with politicians getting "dirty" in blue jeans) not the reality of big agro-business and their incentivized rent-seeking behavior. The last actor, the public, is a *de facto* group but not due to any intentional organization. By definition, this is the rest of the non-organized, not necessarily vocal on this particular issue (although there certainly may be partisan influences). In other words, this is the group of winners that is, most likely, unaware that they are the ones who stand to gain from increased free trade. Furthermore, their involvement as the targets in the war of images makes them a group that cannot be excluded from consideration.

4. Institutional Interactions

Similar to the groupings, the institutional interactions among these groups follow long established norms. The Executive is the lead negotiating agent but must strike a deal that can be sold at home—both to the Congress and the public. Once this deal is reached, the Executive must do the work of selling it at home through garnering political influence and winning the war of images with the public. The lobbies interact in the established mechanisms of garnering political influence in Washington D.C. and, also, formulate campaigns for the war of images to capture public opinion for their cause. Both pro-subsidy and anti-subsidy—for example manufacturing and service sector—lobbies will seek to influence both the Executive and the Legislative. The Congress is firmly and intentionally in the middle with Executive interactions along with their charge to do what's good for the nation balanced against answering to their constituency and championing what's good for their district. All of these actors will use the mass media arena to sway public understanding and, therefore, opinion. The public is, therefore, the recipients—or victims if you like—of the interactions of the other actors. Their ultimate opinion on the topic, however, has direct and significant impact on the ultimate outcome making them, perhaps, the most important actors in the end.

D. IMPLICATIONS – DOMESTIC LEVEL

It can be seen that the eventual war of images fought to capture the public opinion is of the utmost importance. It will be impossible to predict right now the ultimate

outcome of that war. What can be considered at this time are the various incentives or influences that can be expected to be placed in either side of the scales for comparison. Certainly the Executive will continue to advocate for the benefits of trade liberalization and will bring in influences of security and immigration cooperation with ramifications in the war on terror. Additionally, they will seek to convey how any future trade deal with reductions in subsidies is good for the vast group of consumers. It will seek to join ranks with some of the other linkage sectors that stand to gain from a successfully concluded FTAA via increased Non Agricultural Market Access—or NAMA. Lastly, and most importantly, it will try to minimize or silence the voice of outcry from the agricultural industry by offering the opportunity for increased market access into the large markets of Europe and Asia. This reciprocity will turn out to be the make it or break it factor.

If this reciprocity is present then the argument can successfully be offered that what the farmers and ranchers may lose in guaranteed price supports or direct payments will be more than offset in increased sales to those other large markets. The net effect to domestic agriculture producers would, in fact, be positive. In this situation those straight forward economic gains would accrue equally to them.

If this reciprocity is not present then those lobbies will successfully be able make the argument that they are the clearly defined losers and that they will, in fact, lose. The trade deal at that point will quite easily be seen as slanting the playing field against U.S. producers by stripping them of protection while the EU and Japan maintain their high levels of domestic support. Martin Wolf provides a pessimistic, but accurate, summary with this:

> Unfortunately, what is required is also a revolt against the conspiracy of predatory vested interests. Almost everybody would be better off, and quite quickly, if these interests could be disarmed simultaneously. But this is always hard to achieve. In a democracy with well-entrenched interest-group politics, it is almost impossible.[101]

What can be seen is further evidence of the interrelation of these three levels of analysis in that without success at the international level in reduction of subsidies, there

[101] Martin Wolf, *The Power of Productivity: Wealth, Poverty and the Threat to Global Stability*, Chicago: University of Chicago Press, 2004.

can be no unilateral reduction of U.S. subsidies and, therefore, no bargaining leverage gained for the regional level to move forward with the FTAA.

Graphically, this dual interest outcome is depicted in Figure 5. The pro-subsidy protagonists have a very entrenched position in the absence of reciprocity. If reciprocity can be gained then their preference line flattens out significantly and an agreement is possible. Without this reciprocity, however, an agreement is not possible. That is to say, unilateral reductions of subsidies will not occur. In fact, in the absence of a WTO agreement calling for mutual reduction in this protection, the incentive for the lobbies is to increase the domestic protection and protect those rents.

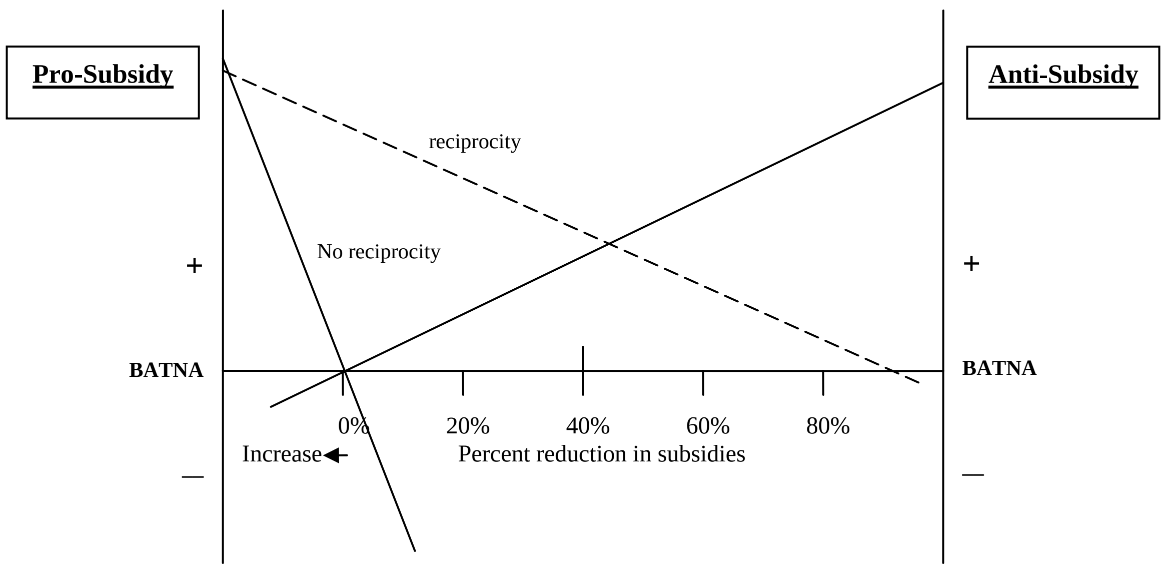

Figure 5. Domestic BATNA Diagram

V. THE PROGNOSIS FOR FTAA

> America is a nation founded on the idea of open exchange and free and fair trade is a win-win for all sides.

—President George W. Bush, swearing in new United States Trade Representative Robert J. Portman, May 2005

The regional analysis concluded that reduction in levels of domestic subsidies was necessary in order for the less-industrialized nations of the hemisphere—championed by Brazil—to concede increased access to the United States in services and government procurement and increased levels of protection for investment and intellectual property. Additionally, the United States stated that these reductions needed to be reciprocated and, therefore, needed to occur within the WTO framework vice the regional FTAA framework. Figure 1 showed that if reciprocated reductions could occur then agreement was possible. Recall that with the given allowable caps a reduction of 50% can occur with no actual lowering of currently employed levels. In order for the reduction to yield genuine increased access it must, therefore, be a reduction of 60% or greater. That level of reduction was represented in Figure 1 as the dashed line. Figure 6 reproduces that figure but depicts the result of a WTO agreement with reduction levels below that 60% threshold—levels that France says it cannot agree to.

The result is that even if the WTO agreement is reached in time, if it is not an adequately large reduction then the real-world levels of protection are not reduced and access is not increased to the U.S. market. In the absence of this access the Latin American countries will not concede the access and protection that the United States wants and the FTAA will not proceed.

The analysis of the domestic chapter further confirms the unreciprocated line in Figure 6. Without the compensation of increased access to the world's other large markets, the U.S. producers will not support reduction in their protection.

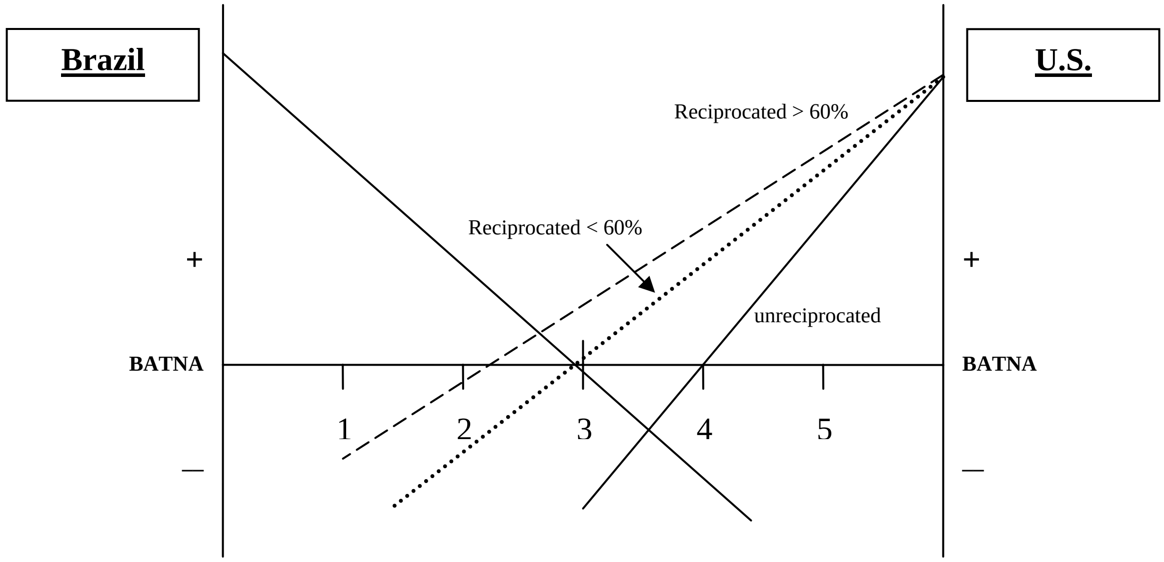

Figure 6. Corrected Regional BATNA Diagram

1. Subsidy reduction, no services / procurement access, no investment or intellectual property protection, no environmental or labor standards.
2. Subsidy reduction, small access / protection, no environment / labor.
3. No subsidy reduction, small access / protection, no environment / labor.
4. No subsidy reduction, small access / protection, small environment / labor.
5. No subsidy reduction, full access / protection, stringent environment / labor.

The FTAA represents an enormous potential trading bloc with nations all across the spectrum of economic and industrial development. For the nations at the less developed end, the concerns are guaranteed and genuine market access in order to foster sustained economic growth. The majority of the goods coming into the large markets in the hemisphere already come in duty free, but the very sectors that many of the Latin American nations have a comparative advantage in are sensitive sectors in the United States and are, therefore, protected with subsidies. This market access, that the majority of the hemispheric nations demand, means that the large markets must dramatically lower its protection in subsidies—and also stop using trade remedies as protectionist weapons.

For the nations at the more developed end of the spectrum, the concerns are for protection of investments and intellectual property rights, fair competition for

government procurement contracts and, access to markets for services. In order for the United States to "buy" this basket of goods it must "spend" its domestic protection. The analysis from the U.S. perspective, therefore, revolves around how to achieve this reduction in domestic subsidies.

The United States stated firmly that it could not reduce this protection unilaterally without reciprocity from the other large global competitors—specifically the EU and Japan. The fate of the FTAA, therefore, became tied up in the success or failure of WTO negotiations to multilaterally reduce domestic subsidies. While those negotiations managed to stave off complete failure with an eleventh hour agreement in Hong Kong to eliminate all export subsidies by 2013 and a commitment to hammer out a framework for modalities on domestic subsidies by 30 April of this year, it is unlikely that a good enough deal can be reached in time.

Two factors at the domestic level are putting significant time pressure on these negotiations to be concluded this year for ratification in early 2007. Those factors are expiration of Trade Promotion Authority—TPA or "fast track"—and the upcoming 2007 U.S. Farm Bill. The consequences of these two Congressional items are that if an FTAA agreement cannot be reached by the end of this year so that it can be ratified prior to the expiration of TPA, then negotiations will, likely, halt until 2009—or limp along with no real impetus—and no reductions on subsidies can begin to be phased in until 2012. The last important domestic level finding is that unilateral reduction of domestic subsidies, in order to get FTAA moving independently of WTO progress, is very unlikely. The issue of domestic support for agriculture harkens back to some idyllic pastoral way of life and, as such, has significant iconic power. The best way to silence the strong voice of these potential losers is to offset the reduction in protection with increased market access to the other large global markets—EU and Japan. Such reciprocity directly benefits the farmers and ranchers who stand to lose their rents from subsidies. In the absence of this reciprocity the war of images will depict the clear losers as poor mom and pop farmers having to give up the generations old family farm. The winners in this circumstance are the consumers at large—measured in the tens or hundreds of millions—who will gain increased selection and reduced prices for both imported and domestic goods. These gains measured per capita are, however, very small and are, likely, not sufficient to

garner support from these consumers when the losers are specifically identified. With reciprocity, these consumers can accurately be convinced that the situation is win-win; without this reciprocity, not enough of these consumers are willing to put the farmers and ranchers out of work to save a few cents.

In the final analysis, the United States must reduce domestic subsidies in order to get its hemispheric neighbors to agree to the FTAA. At this moment in time, the United States is unable to gain sufficient reductions multilaterally through the WTO and is equally unable to unilaterally reduce this protection at home. The conclusion, therefore, must be that the FTAA will not be completed successfully this year and, therefore, cannot be completed until 2009 at the soonest. Hemispheric trade deals will, therefore, continue as bilateral and smaller subregional agreements with nations willing to negotiate deals that do not include reduction of sensitive sector protection. The silver lining is that there appears to be several hemispheric neighbors willing to do just that.

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